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No. 87-——

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FINA OIL AND CHEMICAL COMPANY, *et al.*,
Petitioners,

v.

EL PASO NATURAL GAS COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE FIRST SUPREME JUDICIAL DISTRICT OF TEXAS

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QUESTION PRESENTED

Whether an interstate natural gas pipeline company can utilize an incorrect application of federal law governing natural gas, and a misconstruction of this Court's interpretation of such federal law in *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983), to destroy Petitioners' property interests in natural gas producing properties operated by the pipeline, which interests were recognized and preserved by a prior final holding of the United States Court of Appeals for the Fifth Circuit.

LIST OF PARTIES TO THE PROCEEDING*

The Petitioners joining in this petition for a writ of certiorari are:

Charles W. Colwill
Anne Home Emerson, Trustee
Fina Oil and Chemical Company
Anna Lou Home
Teresa Home
Jean E. Keyser
Cassandra Keyser
Barron Kidd
Morris and Flora Mizel
Sun Exploration and Production Company
and
Helen Ulmer Van Atta

The Respondent is El Paso Natural Gas Company

---

*Petitioners are of the belief that only those parties joining in this petition for writ of certiorari as listed above retain any interest in the outcome of this proceeding. A list of the defendants/appellees in the Court of Appeals for the First Supreme Judicial District of Texas, the petitioners for writ of error in the Supreme Court of Texas, and the respondents in the Supreme Court of Texas is printed at App. 63a-67a.

RULE 28.1 LISTING

The following is a list of all parent companies, subsidiaries (except wholly-owned subsidiaries) and affiliates of Petitioner FINA OIL AND CHEMICAL COMPANY:

American Petrofina, Incorporated
Petrofina Delaware, Incorporated
American Petrofina Exploration Company
American Petrofina Holding Company
Petrofina, S.A.
Comanche Springs Fuel Center, Incorporated
Petro-Phenix, Incorporated
Dal-Fin, Incorporated
Finachem Sales Corporation
Cos-Mar, Incorporated
Cape Industries
Harcofina
The K-T Oil Corporation

The following is a list of all parent companies, subsidiaries (except wholly-owned subsidiaries) and affiliates of Petitioner SUN EXPLORATION AND PRODUCTION COMPANY:

Sun Company, Inc.
Blackfeet Indian Writing Company, Inc.
National Railway Utilization Corporation
Lavan Petroleum Company (LAPCO)
Japan Sun Oil Company, Ltd.
Alaska Bulk Carriers, Inc.
Glacier Bay Transportation Corporation
Northbrook Corporation
Oil Insurance Limited
Convenience Store Distributing Company
Price River Water Users Association
The Wellington Canal Company
Canyon Reef Carriers, Inc.
East Texas Salt Water Disposal Company
Sun Energy Partners, L.P.
Van Salt Water Disposal Company
Hemisphere Oil Company, Inc.
Sun Hydroponics Limited

Deepsea Ventures, Inc.
Ocean Mining Associates
Liberian International American
Explorer Pipeline Company
Inland Corporation
Mid-Valley Pipeline Company
Industries for Tulsa, Inc.
West Texas Gulf Pipe Line Company
China Sun Oil, Ltd.
Sunolin Chemical Company
White River Shale Oil Corporation
The VLM Corporation
Suncor Inc.
Albersun Pipeline Ltd.
Athabasca Realty Company Limited
Baron Petroleums Inc.
Carnduff Gas Limited
GOW Fuels Inc.
Maywelle Properties Ltd.
Nottingham Gas Limited
Oulmet-Gobeille Inc.
Pacgas Limited
Redwater Water Disposal Company Limited
SMS Petroleums Ltd.
Sultran Ltd.
Sun Oil Company of Canada Limited
Sun-Canadian Pipe Line Company Limited
Suncor Supply Limited
Sunoco Home Comfort Inc.
Muskoka Oil Company Limited
Sunoco Inc.
Chemsum Inc.
Fair Wind Shipping Inc.
Solartech Limited
Sunchem Inc.
Sunchem (U.K.) Limited
Trillium Exploration Corporation
Lugrasa, S.A.
Petromech SDN. BHD.
Venezoil C.A.

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OCTOBER TERM, 1987

No. 87-——

FINA OIL AND CHEMICAL COMPANY, *et al.*,
Petitioners,

v.

EL PASO NATURAL GAS COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE FIRST SUPREME JUDICIAL DISTRICT OF TEXAS

Petitioners pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the First Supreme Judicial District of Texas ("Texas Court of Appeals") in No. 01-84-00350-CV issued on August 7, 1986.

OPINIONS BELOW

The opinion of the Texas Court of Appeals is reported at 733 S.W.2d 541 (Tex. App.-Houston [1st Dist.] 1986, writ ref'd n.r.e.), and is printed at Appendix (App.) 1a-28a. The Texas Court of Appeals affirmed in part, and reversed in part, a judgment of the 11th Judicial District Court of Harris County, Texas ("Texas District Court") in No. 83-50539. A copy of the unreported opinion of the Texas District Court is printed at App. 41a-49a. The Supreme Court of Texas denied Petitioners'

application for a writ of error "N.R.E." (no reversible error) by an unreported order printed at App. 37a-38a, and Petitioners' motion for rehearing by an unreported order printed at App. 39a-40a.

JURISDICTION

The judgment of the Texas Court of Appeals was entered on August 7, 1986. App. la. The Supreme Court of Texas denied Petitioners' application for a writ of error on July 8, 1987, and denied Petitioners' motion for rehearing on September 16, 1987. App. 37a, 39a.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3) (1982).

STATUTORY PROVISION INVOLVED

Section 104 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3314 (1982), sets forth the statutory ceiling price for the sale of natural gas committed or dedicated to interstate commerce prior to the enactment of the NGPA. Section 104 of the NGPA is printed at App. 68a-69a.

STATEMENT OF THE CASE

This controversy involves the efforts of Respondent, an interstate natural gas pipeline company, to implement a rate structure under the Natural Gas Policy Act, 15 U.S.C. §§ 3301 *et seq.* (1982) ("NGPA"), that could be utilized in the state courts of Texas to terminate Petitioners' royalty interests in certain natural gas producing properties operated by the Respondent. Respondent incorrectly claimed in the proceedings before the Texas courts that such rates were *required* under the NGPA and this Court's landmark decision in *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) (hereinafter *Mid-Louisiana*), even where the result of the rate change is to *reduce* the maximum lawful price applicable to the gas in question.

This controversy also involves a final decision of the United States Court of Appeals for the Fifth Circuit. This decision determined that Petitioners have a valid right under federal law to maintain their royalty interests in the properties at issue. *El Paso Natural Gas Co. v. Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983), *cert. denied*, 468 U.S. 1219 (1984) (hereinafter *Sun Oil*).

In holding for Respondent, the Texas Court of Appeals erroneously interpreted the NGPA and *Mid-Louisiana*, and determined that Petitioners' royalty interests could be terminated, contrary to the prior holding in *Sun Oil*.

1. Background Of The Agreements At Issue And The *Sun Oil* Litigation

The royalty interests at issue exist under four similar gas lease agreements (GLA's) entered into between Petitioners and Respondent in the early 1950's. Pursuant to the GLA's, Respondent obtained from Petitioners or their predecessors-in-interest certain leasehold interests in lands located in the "Four Corners" region of New Mexico.

The GLA's conveyed undeveloped acreage to Respondent. Respondent received the working interest right to explore for, develop and produce natural gas on that acreage. In consideration, Petitioners received an overriding royalty on the gas produced from the acreage. These royalties were not expressed as a percentage of the value of the gas. Rather, the overriding royalties were established in terms of cents per thousand cubic feet (MCF) of gas produced on the GLA properties, subject to escalation as provided by the agreements.[1]

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[1] A general description of the GLA's is set forth by the United States Court of Appeals for the Fifth Circuit in *Sun Oil*, 708 F.2d at 1013-16. A more detailed explanation of the background and intended operation of the GLA's is included in the federal district court decision affirmed in *Sun Oil*. *See* El Paso Natural Gas Co. v. Sun Oil Co., 426 F. Supp. 963 (W.D. Tex. 1977).

Respondent instituted the litigation that culminated in the Fifth Circuit's *Sun Oil* decision in September of 1973 in United States District Court for the District of Columbia. This action was initiated to forestall the efforts of numerous royalty owners to obtain an increase in the royalty payments due pursuant to the terms of the GLA's. In particular, Respondent sought to have the royalty owners declared to be sellers of gas subject to federal pricing restrictions under the Natural Gas Act, 15 U.S.C. §§ 717 *et seq.* (1982) ("NGA").[2] Respondent also initiated a proceeding at the Federal Power Commission ("FPC") seeking the same result. *See Sun Oil*, 708 F.2d at 1014.

During the pendency of the *Sun Oil* litigation, Petitioners and Respondent under each GLA entered into identical settlement agreements (the "1974 Settlement Agreements") which resolved all issues under the GLA's, including the amount of the royalty to be paid, other than the issue of Natural Gas Act jurisdiction. App. 52a-62a. The 1974 Settlement Agreements generally set the royalty to be paid at a rate equal to the highest rate of general applicability prescribed by the FPC, less seven cents. *See* App. 54a; *See also* 733 S.W.2d at 546, App. 6a. The FPC subsequently held that the royalties paid pursuant to the 1974 Settlement Agreements were reasonably and prudently incurred costs and that Respondent was entitled to include these costs in its rates in all subsequent rate proceedings. *El Paso Natural Gas Co.*, 57 F.P.C. 989, 999 (1977).

In February 1977, following a transfer of the case from the United States District Court for the District

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[2] By having the overriding royalty owners declared to be jurisdictional sellers of gas, the amounts payable under the GLA's would be subject to ceiling rates established by the FPC for independent-producers of natural gas. Because these rates were lower than the amount El Paso owed in royalties for GLA production, El Paso would be able to acquire gas for less by "purchasing" the GLA gas rather than by producing such gas and paying royalties on that production. *See Sun Oil*, 708 F.2d at 1014.

of Columbia, the United States District Court for the Western District of Texas concluded that Petitioners were not engaged in jurisdictional sales of gas. *El Paso Natural Gas Co. v. Sun Oil Co.*, 426 F. Supp. 963 (W.D. Tex. 1977). However, in subsequent litigation before the Federal Energy Regulatory Commission (the "FERC" or "Commission"), litigation also initiated by Respondent, the Commission concluded that the overriding royalty owners were indeed jurisdictional sellers of gas. *El Paso Natural Gas Co.*, 12 F.E.R.C. (CCH) ¶ 61,297 (1980).

On July 5, 1983, after a review of the merits of the United States District Court's decision and the inconsistent decision of the FERC, the United States Court of Appeals for the Fifth Circuit held in *Sun Oil* that the overriding royalty owners, including Petitioners, were *not* making sales of gas subject to FERC jurisdiction. Accordingly, the court reversed the FERC order and affirmed the judgment of the United States District Court. The Fifth Circuit concluded that Petitioners, as royalty owners, were not subject to federal pricing limitations and were therefore "entitled to the rate provided in the contracts." 708 F.2d at 1016. This Court subsequently denied Respondent's petition for writ of certiorari, *sub nom.*, in *California v. Tenneco Oil Co.*, 468 U.S. 1219 (1984).

2. The NGPA And Respondent's Initiation Of The Proceedings Below

On August 1, 1983, less than three weeks after the Fifth Circuit's decision in *Sun Oil*, and prior to this Court's denial of the petitions for a writ of certiorari, Respondent initiated the proceeding below in the District Court for Harris County, Texas. In this litigation, Respondent claimed that the NGPA, enacted nearly five years before, had given rise to a right to reassign the interests held by Respondent under the GLA's to Peti-

tioners, thereby destroying Petitioners' royalty interests under the GLA's. Respondent based its claim on this Court's landmark *Mid-Louisiana* decision. Specifically, Respondent claimed that the NGPA, as interpreted by *Mid-Louisiana*, forced Respondent to *lower* the rates that Respondent could collect for production from the GLA properties to a level less than the royalty payments to Petitioners.

This result occurred, Respondent claimed, because *Mid-Louisiana* compelled it to change its cost-based rates ("cost-of-service pricing"), which included Petitioners' royalty payments as a cost, to the NGPA-specified prices applicable to independent-producers ("producer-parity pricing"). Based on this erroneous predicate, Respondent claimed the right to terminate Petitioners' royalty interests by reassignment of the GLA properties to Petitioners under so-called "unprofitability" and "noncommercial acreage" clauses contained in the GLA's. Respondent argued that such clauses were triggered because its former cost-of-service rates included the overriding royalties payable to Petitioners, but its new producer-parity rates did not.

Petitioners contested Respondent's interpretation of the NGPA and *Mid-Louisiana* in the proceedings below. The Petitioners showed, and the Texas District Court so found, that neither the NGPA nor *Mid-Louisiana* required that El Paso abandon cost-of-service pricing as to the GLA properties. App. 47a. Rather, Petitioners demonstrated that Respondent's action was simply part of a corporate plan to maximize profits utilizing a rate filing purportedly compelled by *Mid-Louisiana*. Respondent's plan included the utilization of its *Mid-Louisiana* rate implementation as a basis for extinguishing Petitioners' royalty rights under the GLA's. Based on Respondent's publicly filed documents and internal studies, the Texas District Court issued findings that Respondent contem-

plated a net increase in corporate revenues, based upon its proposed implementation of *Mid-Louisiana*, of $3.8 billion over twenty years. But Respondent could increase its net realization from the change to $4.6 billion if Respondent could utilize *Mid-Louisiana* to terminate its royalty obligations to Petitioners. App. 50a-51a.

The Texas District Court rejected Respondent's construction of the NGPA and *Mid-Louisiana* and held that Respondent did not have the right to terminate Petitioners' royalty interests by reassignment of the GLA properties. App. 41a.

The Texas Court of Appeals reversed the trial court's findings and conclusions of law as to the interpretation and application of the NGPA and *Mid-Louisiana*. The Texas Court of Appeals incorrectly held that under *Mid-Louisiana*, the producer prices specified by Title I of the NGPA, 15 U.S.C. §§ 3311-3333 (1982), constituted the maximum amount that Respondent could collect in its rates, absent special relief authorization from the FERC for a higher rate. 733 S.W.2d at 545-46, App. 4a, 6a. Thus, the Texas Court of Appeals held that Respondent properly abandoned cost-of-service pricing and implemented producer-parity pricing, predicated upon its conclusion that the NGPA and *Mid-Louisiana* required identical pricing for pipeline and independent-producer production.

Based upon its erroneous construction of federal law, the Texas Court of Appeals reversed the Texas District Court as to Respondent's right to reassign the GLA properties under the "unprofitability" and "noncommercial acreage" clauses in the GLA's. 733 S.W.2d at 555-56, App. 28a. Thereafter, the Supreme Court of Texas denied Petitioners' application for writ of error and motion for rehearing. App. 37a, 39a.

REASONS FOR GRANTING THE WRIT

This case presents a question of exceptional importance concerning the interpretation of the NGPA. The resolution of this issue by the Texas Court of Appeals below would deprive Petitioners of valuable contract and property rights and would permit Respondent to reap improper profits. This result arises solely because of the Texas Court of Appeals' misconstruction of both the NGPA and this Court's landmark decision in *Mid-Louisiana.*

The parties and the courts below agree that pipeline-production is subject to NGPA pricing. This is the holding of *Mid-Louisiana.* The critical issue, however, involves pipeline-production that falls within section 104 (a) of the NGPA, *i.e.*, gas that was committed or dedicated to interstate commerce before the NGPA was enacted and as to which a just and reasonable cost-of-service rate under the Natural Gas Act was in effect.

As to this gas, which includes Respondent's pipeline-production subject to the GLA's, section 104(b)(1) of the NGPA provides that the maximum lawful price shall be "*the just and reasonable rate . . .* established by the Commission which was (or would have been) *applicable to . . . such natural gas on April 20, 1977.*" 15 U.S.C. § 3314 (b)(1)(A)(i) (1982) (emphasis added). The Texas Court of Appeals erroneously interpreted the emphasized language to refer to lower *producer* prices in effect on April 20, 1977, rather than any higher just and reasonable cost-of-service rates in effect on such date. 733 S.W.2d at 546, App. 6a.

1. The Texas Court Of Appeals' Decision Erroneously Interprets The NGPA, As Demonstrated By *Mid-Louisiana* And Other Federal Authority

The construction of the NGPA and *Mid-Louisiana* asserted below by Respondent and accepted by the Texas Court of Appeals is wrong as a matter of law. The same

issue, the appropriate pricing of pipeline production under section 104 of the NGPA, was recently addressed in *Public Utilities Comm'n of California v. FERC*, 817 F.2d 858 (D.C. Cir. 1987) (hereinafter *California v. FERC*).

In *California v. FERC*, the United States Court of Appeals for the District of Columbia Circuit addressed the issue of whether, pursuant to NGPA section 104, Respondent was required to abandon cost-of-service pricing and adopt producer-parity rates. In considering this issue, the D.C. Circuit rejected the position of Respondent as adopted by the Texas Court of Appeals below. Specifically, *Mid-Louisiana* did *not* require that Respondent abandon cost-of-service rates and adopt rates applicable to independent-producers. As stated by the D.C. Circuit in *California v. FERC*:

> [T]he Supreme Court's *Mid-Louisiana* decision did not *mandate* parity pricing treatment of pipeline-producer and independent-producer gas. Rather, as our court pointed out [in *Phillips Petroleum Co. v. FERC*, 792 F.2d 1165 (D.C. Cir. 1986)], the Supreme Court in *Mid-Louisiana* explicitly assumed that the [Natural Gas Act] reference point for pipeline prices under the NGPA would be derived from old cost-of-service levels, not the national levels applicable to independent producers.

817 F.2d at 864.

Based on *Mid-Louisiana*, as applied in *California v. FERC*, the D.C. Circuit remanded matters related to Respondent's implementation of NGPA pricing in its rates for reconsideration by the FERC.[3] *Id.*

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[3] El Paso's implementation of producer-parity prices is subject to the outcome of any Commission order implementing *Mid-Louisiana*. El Paso Natural Gas Co., 24 F.E.R.C. (CCH) ¶ 61,390 (1983). Subsequent to *California v. FERC*, the Commission issued Order No. 391-B, 40 F.E.R.C. (CCH) ¶ 61,174 (1987), which permits

[Footnote Continued]

Similarly, in *Columbia Gas Development Corp. v. FERC*, 651 F.2d 1146 (5th Cir. 1981) ("Columbia Gas"), the Fifth Circuit stated that the NGPA "incorporates and carries forward all prior FPC rate orders."[4] As discussed *infra* p. 4, Respondent had already received FPC authorization to collect its royalty payments made pursuant to the GLA's in its cost-of-service rates.[5] Under *Columbia Gas*, (and *California v. FERC*), Respondent's NGPA rate on the GLA gas was its cost-of-service rate, which included royalty payments to Petitioners.

The fundamental error of federal law committed by the Texas Court of Appeals is shown by contrasting the holdings in *California v. FERC* and *Columbia Gas* with the following discussion of *Mid-Louisiana* by the Texas court:

> The U.S. Supreme Court in *Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319, decided on June 28, 1983, *held that the maximum lawful prices fixed in the NGPA* applied to intracorporate transfers from the production department of a pipeline to the distribution department and *fixed the amount which could be passed through by the pipeline to its customers* as its cost of acquisition.
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pipeline-producers to *raise* prices to NGPA Section 104 ceiling rates. Order No. 391-B does not, however, specifically address the issue of pipeline-producers abandoning prior cost-of-service rates and adopting the *lower* section 104 rate to avoid contractual obligations. On October 7, 1987, the Commission granted rehearing of Order No. 391-B for the purpose of further consideration. 52 Fed. Reg. 37,928 (Oct. 13, 1987).

[4] *See also* Kentucky-West Virginia Gas Co., 21 F.E.R.C. (CCH) ¶ 61,251 at 61,552 (1982) ("[Cost of service] treatment was continued by the FERC under the NGPA").

[5] As of April 20, 1977, El Paso had been authorized in its future rate cases to include the royalties paid Petitioners in its just and reasonable rates. *See* El Paso Natural Gas Co., 57 F.P.C. 989 (1977).

> [At the time this case was tried] $3.35 per MMBtu was the price at which the royalty payable [to Petitioners] was computed. [El Paso's] GLA wells were either [NGPA] section 104 or section 103 wells. *The maximum price at which gas produced from section 104 wells could lawfully be sold was .85 [sic] cents per MMBtu. The maximum price at which gas produced from section 103 wells could lawfully be sold was $2.85 per MMBtu.* Those facts demonstrate that *El Paso paid to the defendants more in overriding royalties* on gas produced from GLA wells *than it could lawfully charge its customers* for the gas produced from those wells.

733 S.W.2d at 545-46 (emphasis added), App. 4a, 6a.

Contrary to the holding of the Texas Court of Appeals, the maximum rates under *Mid-Louisiana* were not the producer-parity prices quoted. In fact, the Texas Court of Appeals' interpretation of section 104 directly contradicts this Court's statement in *Mid-Louisiana* that "[u]nder § 104, such gas retains its former NGA price, subject to increases over time for inflation." 463 U.S. at 342-43. As shown by *California v. FERC* and *Columbia Gas*, and as construed by this Court in *Mid-Louisiana*, Congress' intent with respect to section 104 was to carry forward the former NGA cost-of-service price on pipeline production, unless the gas qualified for higher incentive rates established by other pricing categories in the NGPA.[6]

2. The Profits That Would Be Achieved By Respondent Further Demonstrate The Conflict With *Mid-Louisiana*

The record in this case demonstrates that Respondent's substitution of producer-parity pricing for its just and reasonable cost-of-service rates was intended to enhance

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[6] Pipeline-production may qualify for producer-parity rates higher than the pipelines cost-of-service rate "if it falls within one of the special categories of gas whose production Congress saw a need to stimulate." *Mid-Louisiana*, 463 U.S. at 343.

the profitability of the interstate pipeline. Further, by utilizing its producer-parity rate implementation as the basis for extinguishing its royalty obligations to Petitioners in the Texas courts, Respondent sought further to increase the profitability of the pipeline. As found by the Texas District Court, Respondent expected to increase its net revenues by $3.8 billion through the implementation of producer-parity pricing, and to increase this amount to $4.6 billion if it could also extinguish Petitioners' royalty rights. App. 50a-51a.[7]

In *Mid-Louisiana*, the Court clearly contemplated that subjecting pipeline production to NGPA pricing would not provide a means for additional profit, except to the extent the production qualified for the higher incentive rates provided by the NGPA. *Mid-Louisiana*, 463 U.S. at 341-43. Neither the NGPA nor *Mid-Louisiana* permits a pipeline to *reduce* its former NGA cost-of-service rate in order to capture additional profits through the elimination of royalty obligations.[8] The Texas Court of Appeals' decision would allow Respondent to enjoy extraordinary profits beyond any amount intended by *Mid-Louisiana*, as found by the Texas District Court and acknowledged by the Texas Court of Appeals. 733 S.W.2d at 551, App. 18a-19a. This result is clearly inconsistent with the NGPA and *Mid-Louisiana*.

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[7] Respondent contemplated such profits because changing from cost-of-service pricing to producer-parity pricing *increased* the rates Respondent could collect above its costs for most properties. Respondent would realize the incremental amount (the difference between $3.8 billion and $4.6 billion) if it could also utilize producer prices to terminate its royalty costs to Petitioners in the litigation below, and capture the resulting difference beween producer prices and its reduced costs of operation as additional profit.

[8] If the cost-of-service rate established for such gas and carried forward by section 104 is higher than any otherwise applicable producer-parity rate, section 101(b)(5) of the NGPA requires application of the section 104 cost-of-service rate. *See* 15 U.S.C. § 3311(b)(5) (1982) ("[T]he provision which could result in the highest price shall be applicable").

3. Granting The Writ Will Preserve The Integrity Of Petitioners' Contract Rights And Property Interests As Intended By *Sun Oil*

As shown above, Respondent's goal of realizing significant additional profits by abandoning cost-of-service rates applicable to production from the GLA properties in favor of producer-parity pricing is contrary to the NGPA and the expressed intent of this Court in *Mid-Louisiana*. In addition, Respondent's effort to deprive Petitioners of valuable property rights under the GLA's contradicts the prior holding of the Fifth Circuit in *Sun Oil*.

In 1983, following years of litigation before the United States District Court, the FERC and the United States Court of Appeals for the Fifth Circuit, Petitioners' contract and property rights under the GLA's were vindicated. The Fifth Circuit found, after a complete review of the agreements and the merits of the litigation, that the Petitioners were entitled to receive the consideration bargained for under the GLA's. *Sun Oil*, 708 F.2d at 1016. This Court found no reason to alter the decision of the Fifth Circuit and denied all petitions for writs of certiorari. *California v. Tenneco Oil Co.*, 468 U.S. 1219 (1984).

The erroneous application of federal law by the Texas Court of Appeals should not be permitted to upset the holding in *Sun Oil*. Petitioners respectfully urge the Court to grant this petition for a writ of certiorari in order to preserve Petitioners' rights and the integrity of the holding in *Sun Oil*.

CONCLUSION

Certiorari is appropriate where a state court decision conflicts with a federal court of appeals on a matter of federal law. *See, e.g., Edward Katzinger Co. v. Chicago Metallic Mfg. Co.*, 329 U.S. 394 (1947); *MacGregor v. Westinghouse Electric & Mfg. Co.*, 329 U.S. 402 (1947).

Certiorari is also appropriate where necessary to determine whether a state court has properly applied a prior Supreme Court decision. *See, e.g., Hankerson v. North Carolina*, 432 U.S. 233 (1977). In this controversy, both of these criteria have been met. The holding of the Texas Court of Appeals below is inconsistent with the NGPA as construed in this Court's landmark decision in *Mid-Louisiana*. Unless corrected, Respondent will realize extraordinary profits, contrary to the expressed intent of this Court. Further, Petitioners will be deprived of their valuable rights under the GLA's which were recognized and preserved by the Fifth Circuit in *Sun Oil*.

The petition for writ of certiorari should be granted.

Respectfully submitted,

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No. 87——

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

FINA OIL AND CHEMICAL COMPANY, *et al.*,
Petitioners,

v.

EL PASO NATURAL GAS COMPANY,
Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE FIRST SUPREME JUDICIAL DISTRICT OF TEXAS

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APPENDIX A

COURT OF APPEALS
FIRST SUPREME JUDICIAL DISTRICT

No. 01-84-00350-CV

EL PASO NATURAL GAS COMPANY,
Appellant

v.

AMERICAN PETROFINA COMPANY OF TEXAS, *et al.*,
Appellees

On Appeal from the 11th District Court
of Harris County, Texas

Trial Court Cause No. 83-50539

OPINION

El Paso Natural Gas Company is, and has been for many years, a major interstate natural gas pipeline. As such, it owns and operates about 9,500 gas producing wells. Its gas delivery system consists of 21,000 miles of pipeline and necessary facilities connected therewith. Three thousand two hundred of its gas wells are on property located in the San Juan Basin in New Mexico and are the subjects of the assignments the validity and construction of which are involved in this case. It was the plaintiff in the trial court and is the appellant here. It will sometimes be referred to in this opinion as El Paso or appellant.

In the early 1950's there was a growing demand from potential gas users on the west coast of the United States, particularly in California. El Paso, in response to that

demand, sought to increase its source of supply of natural gas. Its attention was directed to an area in northwestern New Mexico known as the San Juan Basin. Much of the area within that basin had already been leased, but the holders of the leases were hesitant to develop the field fully because of the expense of doing so.

Delhi Oil Company, controlled by Mr. Clint Murchison, was the holder of leases covering more than 100,000 acres of the basin. Mr. Paul Kayser, president of El Paso, approached Mr. Murchison in 1951 to negotiate a deal whereby El Paso could acquire the gas to be produced from the Delhi leases. The culmination of those negotiations was the execution of a written agreement called a Gas Lease-Sales Agreement (GLA 47). By GLA 47, Delhi agreed to sell its leasehold interests in the San Juan Basin to El Paso. The consideration El Paso agreed to pay to Delhi was an overriding royalty interest in the assigned leases. The overriding royalty interest was expressed as a specific sum of money per thousand cubic feet (Mcf) of gas produced from the leases. The amount of the override began at 5.5 cents per Mcf and increased at an agreed rate for the next 12 years, at which time the parties would either agree upon a new rate or would submit the matter to arbitration. The maximum rate to which the fixed royalty increased during the primary term that was provided was 10 cents per Mcf.

In addition to the overriding royalty to be paid in cash, GLA 47 provided that the assignor should get ⅓ of the liquid produced along with gas produced from the leases. The assignor was given the choice as to taking these liquids in kind or being paid in their cash value.

El Paso continued its search for new sources of gas after its acquisition of the Delhi leases. By that search, it acquired other leases from other lessees in the San Juan Basin. Those other leases were assigned to it by GLA's substantially in the form of GLA 47. (The minor

differences will be discussed hereafter.) This case involves the construction of GLA 47 and 12 other GLA's pursuant to which El Paso was assigned the rights to leases in the San Juan Basin.

In 1938, before the facts giving rise to this controversy occurred, Congress enacted the Natural Gas Act (NGA). Ch. 556, 52 Stat. 821 (1938) (codified as amended at 15 U.S.C. secs. 717-717z (1982)). By that Act, the interstate production, distribution, and sale of natural gas was federally controlled. That Act was administered by the Federal Power Commission (FPC). A basic purpose of the NGA was to limit the rate at which natural gas could be sold in interstate commerce to a "just and reasonable" rate. The determination of whether a proposed rate was "just and reasonable" was made by the FPC. In making that determination, the cost of service incurred by the proposed seller was a basic factor.

El Paso, itself, was the producer of some of the gas that it distributed through its pipeline system and sold to users. Thus El Paso was, as to part of its gas, both a producer and a pipeline. Much of the gas acquired by pipelines generally for sale to users is produced by independent producers and sold to the pipelines. The price at which such gas was bought by the pipelines, if a "prudent" price, was a factor in determining the pipeline's "cost of service," which, in turn, was a factor in determining whether its proposed rate was "just and reasonable." As to a pipeline that produces the gas that it distributes and sells, rather than buys it from an independent producer, there was no purchase price to use in calculating its cost of service. Instead, the pipeline's cost of producing the gas, determined in accordance with accounting principles, was used.

In 1978, Congress enacted the Natural Gas Policy Act (NGPA), Pub. L. No. 95-621, 92 Stat. 3350 (codified at 15 U.S.C. secs. 3301-3432 (1982)). That Act fixed the maximum lawful prices at which gas could be sold in a

"first sale." It established eight different categories of gas production and fixed a maximum lawful price for first sales in each category. It also prescribed a formula for increasing first sale prices each month and passing the cost on the downstream purchasers. This was used for the purpose of adjusting for inflation.

The NGA provided federal control for only interstate gas pipelines and left intrastate regulation, if any, to the states. The NGPA did not repeal the NGA, but did extend federal regulation so as to apply to both interstate and intrastate gas pipeline operations. The NGPA also changed the name of the regulatory agency from the Federal Power Commission to the Federal Energy Regulatory Commission (FERC).

The U.S. Supreme Court in *Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319, decided on June 28, 1983, held that the maximum lawful prices fixed in the NGPA applied to intracorporate transfers from the production department of a pipeline to the distribution department and fixed the amount which could be passed through by the pipeline to its customers as its cost of acquisition. (This case is commonly called "Mid-La" and will be called by that name herein.)

A significant matter of which notice should be taken in recitation of the background of this case is the arbitration in 1973 after the primary term provided in GLA 61, during which the overriding royalty was fixed in cents per Mcf and ⅛ of the liquid produced, expired. Sun Oil Company was the assignor in that GLA and the owner of the overriding royalty incident thereto. Upon the expiration of the primary term, Sun and El Paso undertook to agree on the overriding royalty to be applicable thereafter, but were unable to do so. Whereupon, the matter was, as provided in GLA 61, submitted to arbitration. The arbitration board fixed the amount of the overriding royalty to be paid by El Paso to Sun at 40 cents per

Mcf—four times the highest overriding royalty El Paso had been required to pay during the primary term. The amount of the override so fixed by the arbitration board exceeded the allowable rate for flowing gas of similar vintage established by the FPC pursuant to the NGA.

All of the GLA's involved herein have a "favored nations clause." That clause obliges El Paso to pay each overriding royalty owner a royalty equal to the highest royalty it pays to any other overriding royalty owner. After the Sun arbitration, the other overriding royalty owners took the position that the award of the arbitration board in the Sun matter triggered the favored nations clause of the GLA's under which they held.

After the arbitration board's award in the Sun matter, El Paso filed suit in federal district court seeking a declaratory judgment that the royalty owners were sellers of gas in interstate commerce and that, therefore, the amount overriding royalty they could collect was subject to federal price ceilings. El Paso also filed a complaint with the FPC seeking an order consistent with its claim in the district court.

In 1977, the United States District Court, sitting at Midland, Texas, held that the GLA's were not sales of gas within either its jurisdiction or that of the FPC and dismissed the case. *El Paso Natural Gas Co. v. Sun Oil Co.*, 426 F. Supp. 963 (W.D. Tex. 1977). In 1980, the FERC ruled that the GLA royalty owners were sellers of gas subject to federal pricing limitations and subject to the FERC's jurisdiction. In 1983, the Fifth Circuit affirmed the district court's action and reversed the FERC's ruling. *El Paso Natural Gas Co. v. Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983). After the Sun arbitration award, and while the Sun Oil Co. case was pending, El Paso could not obtain rate relief from the FPC, because the amount of El Paso's liability had not been finally determined. To alleviate this problem, the parties

entered into settlement agreements referred to as the 1974 settlement agreements. By those agreements they provided for amendment of the terms of the GLA's. As to the amount of the overriding royalty payable under the GLA's, the agreements provided that the amount should be set on June 1 of each year at an amount:

> . . . equal to the highest rate prescribed or permitted by the Federal Power Commission (or by any successor federal agency having authority to review or establish rates for natural gas flowing in interstate commerce) for natural gas flowing in interstate commerce . . . less seven (7) cents per Mcf; provided, however, that in determining such highest rate only those rates of general applicability which are prescribed or permitted with respect to sales of gas at the wellhead shall be considered. . . .

At the time this case was tried before the trial court the "highest price" that was to be used as the basis for computing the overriding royalties payable to the defendants was the price fixed by section 102 of the NGPA—that is, the maximum price at which gas produced from section 102 wells could lawfully be sold. That price was $3.42 per MMBtu, which, less .07 cents, or $3.35 per MMBtu, was the price at which the royalty payable was computed. El Paso had no section 102 wells. Almost all of its GLA wells were either section 104 or section 103 wells. The maximum price at which gas produced from section 104 wells could lawfully be sold was .85 cents per MMBtu. The maximum price at which gas produced from section 103 wells could lawfully be sold was $2.85 per MMBtu. Those facts demonstrate that El Paso paid to the defendants more in overriding royalties on gas produced from GLA wells than it could lawfully charge its customers for the gas produced from those wells. That is, the overriding royalties were more than 100% of the revenues from the GLA wells.

On August 1, 1983, El Paso gave written notice to the defendant overriding royalty owners that it was reassigning to them, as of October 1, 1983, those wells and leases which they, or their predecessors in ownership, had assigned to it. It tendered to them such written assignments. All of the defendant royalty owners refused to accept El Paso's tenders. El Paso then filed for record its tendered reassignment. Also on the same day, August 1, 1983, El Paso filed this suit. The defendants filed petitions for temporary injunctions to preserve the status quo between parties, and after hearing, the petitions were granted.

In the present case, El Paso sought a declaratory judgment, pursuant to art. 2524-1, as to its rights and duties under the various GLA's and lease assignments under which it owns leasehold rights in the San Juan Basin. El Paso also sought monetary damages. The defendants are those who own the overriding royalty rights provided by those GLA's in question, either as the original assignor or derived through the original assignor. They will herein sometimes be referred to as defendants, appellees, or as royalty owners. The defendants, in answer to El Paso's petition, denied El Paso's contentions with regard to the construction of the GLA's and pleaded a number of affirmative defenses, including limitations, settlement, res judicata, estoppel by judgment, laches, and waiver. The defendants also, by cross action, asked for a declaratory judgment construing the instruments in question in accordance with their claims. Both El Paso and the defendants sought recovery of attorney's fees. Each side asked for an injunction to enforce judgment in its favor.

The case was, by agreement, tried to the court without a jury. The trial court rendered judgment substantially in compliance with the claims of the defendants and cross-plaintiffs. Its various findings of fact and conclusions of law on which that judgment was based will be discussed hereafter. It granted defendants' prayer for

injunction to enforce the judgment and awarded to defendants a recovery of attorney's fees of more than two million dollars. It decreed that El Paso take nothing by its suit and that defendants recover their costs of court.

There are three clauses in the GLA's around which this dispute centers. Those clauses are: (1) the unprofitability clause; (2) the undeveloped acreage clause; and (3) the 500 Mcf clause.

Most of the GLA's contained an unprofitability clause essentially in the following language:

> In the event the operation of any well now or hereafter drilled shall become unprofitable, then El Paso shall have the option upon sixty (60) days notice to [Appellee] to reassign to [Appellee] such well and the unit upon which such well is situated, and in such event, [Appellee] shall have the option to sell gas produced therefrom to El Paso at the highest price paid for gas of like kind and quality in the field by El Paso or any other bona fide pipeline company, and El Paso agrees to purchase such gas at such price.

The undeveloped acreage clause is in the following language:

> In the event that development hereafter in the area of or adjacent to any drilling unit should evidence that such drilling unit will not be productive of gas in commercial quantities in the Mesaverde Formation and for such reason El Paso shall not desire to drill such well thereon, then El Paso shall promptly reassign any such drilling unit to [Appellee] or to any person whom [Appellee] may designate and thereupon shall be relieved of its obligation to drill a Mesaverde test well thereon; provided that El Paso may retain any commercial gas well completed thereon in a shallower or deeper formation, together

with its rights in such drilling unit down through such shallower or deeper formation.

The 500 Mcf clause is in the following language:

> It is understood that the United States Department of the Interior may not approve reservations of the overriding royalties described in paragraphs A, B, C and D above as to federal public domain unless such overriding royalties on any particular lease from which the average production per well per day is less than 500 Mcf of gas are converted to a working interest. It is agreed therefore that [appellee] may in the assignments containing its reservation of such overriding royalties on federal public domain provide for the suspension of such overriding royalties when production is less than such amount; provided, however, that notwithstanding such provision, it is agreed that during any and all such periods when production on any particular lease shall be less than such amount [appellee] shall receive in lieu of such overriding royalties in such lease a portion of the working interest therein (including liquid hydrocarbons after extraction) in an amount to be agreed upon by the parties hereto, and if they cannot so agree, then in an amount to be agreed upon by a board of arbitrators in accordance with Article X hereof. El Paso agrees that in any event [appellee] shall receive such amount of working interest (including liquid hydrocarbons after extraction) in such lease so that after deduction of its part of all costs of operation from the proceeds of the sale of gas therefrom (including the liquid hydrocarbons extracted from such gas) [appellee] shall receive a net amount in cash from such working interest which shall be equal to the amount [appellee] would have been entitled to receive otherwise as overriding royalties from such lease during

such period, and [appellee] agrees to sell such gas to El Paso on such basis.

The construction and application of those three controversial clauses quoted above substantially control this case. We shall discuss them in the order that they are listed.

The Unprofitability Clause

The solution of the question as to the plaintiff's rights under this clause lies in the determination of whether in the computation of the costs and revenues applicable to a well, the overriding royalty that the plaintiffs must pay should be considered a cost. The defendants contend, and the trial court held, that it should not be considered a cost. We hold that the trial court's ruling in that respect was error.

The defendants, in the trial court, relied on the case of *Clifton v. Koontz*, 160 Tex. 82, 325 S.W.2d 684 (1959), as authority for their contention. That case, in turn, cited as authority for its holding the California case of *Transport Oil Co. v. Exeter Oil Co.*, 84 Cal. App. 2d 616, 191 P.2d 129 (1948). We are of the opinion that neither the *Clifton* case nor the *Transport* case is authority supporting the trial court's holding that the overriding royalty that El Paso is required to pay its assignors under the provisions of the GLA's is not a cost to be considered in determining whether a well is unprofitable to it, as that word is used in the instrument by which the well was assigned to it and by which the overriding royalty was created.

Clifton v. Koontz was a case in which a lessor sued its lessee contending that the lease had terminated because it had ceased to produce oil and gas in "paying quantities." The court held that, in calculating the amount of the income attributable to the working interest, for the purpose of determining whether a well was producing in

paying quantities, the lessor could not deduct overriding royalties paid by the lessee. In making this holding the court cited as authority *Transport Oil.*

In *Transport,* an assignee of a lease abandoned the lease, and its assignor, who had retained an overriding royalty interest, sued for damages it had suffered as a result. The assignee defended the suit by claiming that the lease was no longer producing in paying quantities and had, therefore, terminated by its own terms. The assignee-defendant contended that, when applying the "paying quantities" test, the court should deduct from the income from the lease not only the basic royalty payable under the terms of the lease to the lessor, but also the overriding royalties payable to prior lessees. The court held that, when determining whether the lease had terminated under its production-in-paying-quantities provision, a deduction from the income of the lease of the amount of the basic royalty payable to the lessor was proper, but that a deduction of overriding royalty was not proper. As to the landowner-lessor, the assignee-defendant had assumed the leasehold obligations and therefore occupied the same position as the original lessee. The royalty payments to the lessor were therefore deductible. However, overriding royalties, created by instruments to which the lessor was not a party, were not deductibles as costs in determining whether the lease was producing in paying quantities. The overriding royalty payment was not an obligation *to the lessor* that the assignee of the lease assumed.

The parties recognized that a well or lease may be producing in paying quantities and yet be unprofitable to its operator. That is because, in the paying quantities test, only the basic royalty payable to the lessor is considered a cost, whereas in a "profitability" test, the overriding royalty and the basic royalty both are considered costs. This is consistent with the language of 2 H. Wil-

liams and C. Meyers, *Oil and Gas Law*, sec. 420.1 (1985) wherein it is said:

> Both the lessor and the owner of an override, suing on an implied covenant to protect against drainage, may be required to prove that an offset well, if drilled, would have been profitable. In proving profitability, the lessor would prove only that the return from production after deducting landowner royalty would have been sufficient to yield a profit to the lessee; the owner of the override would be required to deduct the override as well as the landowner royalty in determining whether an offset well would have been profitable.

Clifton v. Koontz, involved the application of the "paying quantities" test, which is wholly inapplicable here. If the plaintiff's right to reassign depended on its ability to show that a lease was not producing in paying quantities, then the unprofitability clause was meaningless. That is because, when the lease failed to produce in paying quantities, it automatically terminated by its own provisions in its habendum clause. There would be nothing to reassign. A basic rule in the construction of contracts is that the parties thereto are presumed to have intended its provisions to have some meaning. *City of Pinehurst v. Spooner Addition Water Co.*, 432 S.W.2d 515, 518 (Tex. 1968). The only way to construe the unprofitability clause to have meaning is to construe it as having meant that a lease could become unprofitable even though it was still producing in paying quantities.

The Undeveloped Acreage Clause

The issue involved in construing the undeveloped acreage is similar to that involved in construing the unprofitability clause—what elements are to be considered as costs in determining the ability of a lease to produce in commercial quantities. The GLA's did not define the

term "produce in commercial quantities," probably because the term had such an ordinary signification that its meaning is clear and unambiguous deeming a definition unnecessary. In Webster's New Collegiate Dictionary (1985) the word "commercial" is defined as, "suitable, adequate or prepared for commerce," giving as an example, "found oil in commercial quantities."

We have neither found nor been cited any case in which there is a judicial definition of the term "produce in commercial quantities." The word "commerce" connotes a venture operated for profit. A prudent oil and gas operator, in determining whether to develop theretofore undeveloped acreage, will seek to determine whether the acreage ~~will~~ produce in sufficient quantity that his revenues therefrom will be such amounts as will repay him his cost of development, such as, the cost of drilling and equipping a well or wells; the cost of maintaining his operator's rights, such as the royalties, basic and overriding, which he must pay; his cost of operating a well or wells; and a reasonable return on his investment incident to the development. If it will do so, the acreage will produce in commercial quantities, otherwise it will not.

It is significant here to note also the difference between the position of the operator, El Paso, and that of the operator, lessee, in *Clifton v. Koontz*. There the court held that the lease was producing in "paying quantities" even though it would never produce sufficiently to repay the lessee's costs of drilling the well by which the lease was developed. There the court was considering the situation after the operator had already incurred the cost of developing the lease and that cost had been irrevocably lost to him. Here, in construing the undeveloped acreage clause, we hold that the situation should be viewed prospectively, before the cost of development has been incurred, and not retroactively, after that cost has been irrevocably lost.

We hold, as a matter of law, that the cost of the overriding royalties which El Paso was required to pay in order to maintain its status as holder of its operator's rights, was a cost necessarily to be considered in determining whether undeveloped acreage was capable of producing in commercial quantities, as applied to the facts of this case.

The 500 Mcf Clause

The language of this clause, quoted above, clearly shows that the parties to the GLA's were concerned with a regulation of the Interior Department concerning oil and gas leases of federal lands. That regulation was Section 192.83, as follows:

> Section 192.83—*Limitation of Overriding Royalties.* Any agreement to create overriding royalties or payments out of the production of any lease which, when added to overriding royalties or payments out of production previously created and to the royalty payable to the United States, aggregate in excess of 17½% percent shall be deemed a violation of the terms of the lease unless such agreement expressly provides that the obligation to pay such excess overriding royalty or payments out of production shall be suspended when the average production per well per day averaged on a monthly basis is (a) as to oil, 15 barrels and (b) as to gas, 500,000 cubic feet or less. The limitations in this section will apply separately to any zone or portion of a lease segregated for computing government royalty.

43 C.F.R. sec. 192.83 (1952-53).

In the trial court, El Paso contended that it had the right, under the 500 Mcf clause, to reassign certain wells and the units on which they were located on federal land. The trial court held contrary to El Paso's contention, holding that this clause, rather than giving El Paso the

right to reassign, was a clause by which El Paso agreed to indemnify the overriding royalty owner from any loss in the event the payment of such royalty was suspended. We affirm the trial court's holding in this respect.

The evidence showed that many of the wells on federal leases had, from to time, for many years, fallen below 500 Mcf per day production, and neither party had taken the position that the working interest had reverted to the assignor/holder of the overriding royalty. El Paso had never before attempted to reassign them. The parties' own construction of this clause was consistent with the trial court's holding with regard thereto.

Extent of El Paso's duty to defendants as to its marketing of gas produced from GLA wells:

The defendants contend that the NGPA permits the plaintiff to seek and the FERC to authorize a higher price than that fixed by the NGPA for the sale of its gas. We agree with that contention.

The defendants also contend that the plaintiff, by applying for and getting from the FERC authority to abandon the cost of service method at which it sells its gas, breached an implied duty to them to seek a selling price that would preserve the GLA's profitability. The defendants argue that the implied duty was breached because, by staying on the cost of service method of pricing, El Paso could have passed through to its customers the amount of the overriding royalties it pays to the defendants.

The trial court found the relevant facts consistent with defendants' contentions and concluded as a matter of law that such breach by plaintiffs of its duty to defendants precluded it from reassigning to defendants unprofitable wells and noncommercial acreage.

We hold that in making such findings and conclusion the trial court erred.

The operator of an oil and/or gas lease has an implied duty to act in good faith in marketing the gas of its royalty owners when the amount of the royalty depends upon the price at which the product is marketed. *Amoco Production Co. v. First Baptist Church*, 579 S.W.2d 280 (Tex. Civ. App.—El Paso, 1979), *writ ref'd n.r.e. per curiam*, 611 S.W.2d 610 (Tex. 1980). In the present case, the defendants' royalty income does not depend on the price for which El Paso sells the gas produced from the leases that the defendants assigned. It is based upon the highest amount for which El Paso could lawfully sell any gas produced from the leases. Thus, if El Paso sold gas from the GLA leases for less than the highest price authorized by the NGPA for a "first sale," it paid the overriding royalty owners the same amount as it would have paid if it had sold the gas at the highest price. We, therefore, hold that El Paso did not owe to the overriding royalty owners any implied duty as to the amount for which it sold its production.

The duty in *Amoco* to market in good faith is based on the assumption that the operator is marketing something that belongs to the royalty owners, and retaining some benefit for itself that should rightfully be included in the benefit obtained for the royalty owners. This does not support an implication that a working interest owner must market for a price sufficient to keep a lease assignment in effect when the alternative is to return 100% of the gas to the royalty owners. The existence of a contract (lease assignment) does not give rise to any implied covenant that neither party will do anything that injures the right of the other party to receive the benefits of the agreement. *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983).

The formula by which the overriding royalties that El Paso is obliged to pay to the defendants was negotiated and agreed on in connection with the 1974

settlement agreements before the enactment of the NGPA.

We do not agree with the defendants' contention that the plaintiff owes to them the implied duty to sell its gas produced from the GLA wells for a sufficient price to prevent the wells from being unprofitable and, therefore, reassignable. If there were an implied duty to market in good faith, it did not create a fiduciary duty on El Paso by which it was obliged to subordinate its own interests to those of the defendants. *Amoco Production Co. v. First Baptist Church*, 579 S.W.2d at 284. In *Elliott v. Davis*, 553 S.W.2d 223, 226 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.), it was said,

> We conclude that the standard of good faith is correctly described in Kuntz, The Law of Oil & Gas, sec. 48.3, p. 218, as follows: Although it has been said that the lessee has a fiduciary obligation in the exercise of the pooling power, it is submitted that the lessee is not a fiduciary and that standards applied to fiduciary are entirely too strict. This is so because the lessee has not undertaken to manage and develop the property for the sole benefit of the lessor. The lessee has substantial interests that must be taken into account, and he should not be required to subordinate his own interests entirely to the interests of the lessor. Since his interests frequently conflict with those of his lessor, however, he must exercise the power in fairness and in good faith, taking into account the interests of both the lessor and lessee.

The defendants evidence no hesitation to use the provisions of the NGPA as the basis for increasing the royalties to be paid by El Paso in its production from GLA leases to more than 100% of its revenues from those leases. They can hardly be heard to say that it was unfair for El Paso to use those provisions to avoid the obligation to pay those royalties.

The defendants also contend that El Paso should have sought special relief from the FERC, increasing the price at which it could sell its GLA gas production, because its cost of service was increased by the increased overriding royalties. That amounts to saying that El Paso should have sought an order from the FERC by which the burden of its increased royalties would have been shifted to El Paso's customers, thereby keeping the GLA wells profitable and not reassignable. El Paso argues, in reply to defendants' contention that it had no duty to seek such special relief because it was unlikely that the special relief would be granted, since it had, in the unprofitability clause, a way to avoid its obligations to pay the oppressive royalties. Mr. Charles Curtis, former chairman of the FPC, a witness for El Paso, testified in support of El Paso's contention. The defendants point out that the FERC has approved the 1974 settlement agreements as being prudent. They argue that that approval shows that it would grant El Paso special relief because of the increased royalties provided in that settlement. That argument is not persuasive. At the time the settlement agreement was approved, the relationship between the plaintiff and defendants included the unprofitability clause, which we have held unambiguously gave to plaintiff the right to reassign unprofitable wells. The FERC's approval by no means justifies a conclusion that it would approve the passing through of the increased royalties to El Paso's customers.

As noted above, El Paso owns and produces gas from a number of wells other than the GLA wells. Its application to the FERC for authority to substitute NGPA pricing for its previously used cost of service pricing included, but was not limited to, its GLA wells. El Paso contends that such a substitution would result in an increase in its over-all profit from its pipeline production. The defendants not only do not contend to the contrary, but apparently confirm El Paso's contention. In the brief

filed in behalf of the defendants, Tenneco, Inc., Conoco, Inc. and a number of other defendants say at page 37:

> Simply stated, without regard to its royalty obligations under the GLA's, El Paso's pipeline production is far more profitable if El Paso is ultimately allowed to implement *Mid-Louisiana.*

We hold as a matter of law that El Paso had no duty to the defendants to forego its opportunity to make its "pipeline production far more profitable" by implementing *Mid-Louisiana.*

Situation where only a fraction of the working interest was assigned to El Paso.

In a number of instances the assignments to El Paso did not assign the entire working interest, but only a fraction thereof.

In such a situation the trial court held that it was not sufficient for El Paso to prove that the portion of the well or lease assigned to it was unprofitable, but that it had the burden of proving that the entire well or lease was unprofitable before it could be reassigned pursuant to the unprofitability clause.

We hold that ruling by the trial court to be erroneous. It is impossible for El Paso to reassign that which was not assigned to it. El Paso was, by the unprofitability and undeveloped acreage clauses, authorized to reassign that which had been assigned to it when that which had been assigned to it became unprofitable.

The Affirmative Defenses.

The trial court summarily ruled on the issues raised by the affirmative defenses pleaded by defendants. At paragraph 13 of its judgment it recited a conclusion of law: "All of plaintiff's claims are barred by *res judicata*, settlement, waiver, laches, estoppel and the applicable Statute of Limitations." We shall discuss those defenses individually.

Res Judicata: The defendants based their plea of res judicata on their contention that the claims asserted here by plaintiff had been adjudged against it in the Sun Oil Company case before the federal district court. We hold that plaintiff's claims had not been so adjudicated. Plaintiff's claims asserted in this case are not within the jurisdiction of the federal court that tried the *Sun Oil Co.* case. That court may have been authorized to accept pendent jurisdiction if it chose, but it specifically declined to do so. A judgment rendered by a court having no jurisdiction of claims or rights asserted in a later case does not support a plea of res judicata or estoppel by judgment of claims made in the later case. 18 C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure Sec. 4436 (1981).

Settlement: This defense is claimed to have resulted from the 1974 settlements. We have read carefully the settlement agreement between plaintiff and those defendants who own overriding royalties under GLA 47. We have failed to find any language that can reasonably be construed as having indicated an agreement that either the unprofitability or the undeveloped acreage clause be rendered no longer effective. In fact one of the "whereas" clauses in the preamble recites: "Whereas the parties are desirous of avoiding further disputes and further arbitration and to set at rest the issues in pending litigation and arbitration to determine the applicable overriding royalty to be paid by El Paso to Tenneco-Continental both now and in the future, without disposing of any other issues in such pending litigation." That preamble made quite clear the purpose of the settlement agreement as not including any change of the effect of the unprofitability or undeveloped acreage clauses.

The unambiguous settlement agreement did include language unambiguously cancelling the parties' agreement for arbitration. At paragraph 4 it provided:

> 4. The parties agree that Article XII and Article III, Section 2, Paragraph C, of GLA 47, are hereby suspended only so long as Tenneco-Continental are receiving payment for their overriding royalty in the manner specified in this agreement. In the event of a disagreement or controversy over any provision of this settlement agreement or the application or determination of any rate thereunder, the parties agree that the arbitration provision of GLA 47 shall not apply.

We hold, as a matter of law, that the language of the 1974 settlement does not provide for cancellation or forfeiture of plaintiffs rights under either the unprofitability or the undeveloped acreage clause.

Waiver: Of the defense "waiver," the Supreme Court in *Texas & P. Ry. Co. v. Wood*, 145 Tex. 534, 199 S.W. 2d 652, 656 (1947) said, "A waiver has been frequently defined as an intentional relinquishment of a known right or intentional conduct inconsistent with claiming it." The right to reassign unprofitable wells and noncommercial undeveloped acreage did not accrue until October 1, 1983, the effective date of El Paso's implementation of *Mid-La.* It is true that in the years between the execution of the GLA's containing the unprofitability and undeveloped acreage clauses and the United States Supreme Court decision in *Mid-La*, El Paso had not tried to invoke the unprofitability clause as a basis for reassignment of a well or lease. That, however, was not action (or inaction) inconsistent with its claim of the option to do so if a well or lease became unprofitable.

El Paso did, however, reassign some leases pursuant to the undeveloped acreage clause in the early 1960's, and those reassignments were accepted.

Furthermore, waiver is an affirmative defense of which the defendants had the burden of proof. They had the

burden of proving that El Paso had intentionally waived its right to reassign or had intentionally conducted itself in such a manner as was inconsistent with their having such a right to reassign.

There is no evidence that El Paso intentionally waived its right to reassign under either the unprofitability clause or the undeveloped acreage clause. As to the unprofitability clause, El Paso had the *option* to reassign. Its failure to exercise that option is not inconsistent with a desire to keep an unprofitable well with a hope of making it profitable by reworking it. It was not evidence of conduct inconsistent with claiming a right to reassign it. While the language of the undeveloped acreage clause did not include the word "option," it did, in effect, give El Paso an option to reassign a drilling unit. It provided that if future development in the area of a drilling unit should evidence that such unit will not be productive of gas in commercial quantities and for that reason "El Paso shall not desire" to drill a well thereon, El Paso may reassign the unit.

We hold that there was no evidence establishing that El Paso waived its right to reassign and that the trial court erred in holding that El Paso's claims were barred by waiver.

Laches: In *City of Fort Worth v. Johnson*, 388 S.W. 2d 400, 403 (Tex. 1964), the court said:

> Two of the essential elements of laches are (1) unreasonable delay by one having legal or equitable rights in asserting them and, (2) a good faith change of position by another to his detriment because of the delay. (Citations omitted.)

There is no evidence in this record that supports defendants' burden of proof as to either of those two requisites for the application of the defense of laches. El Paso did not unreasonably delay its assertion of its right to reas-

sign. That right was conditioned on the wells or leases becoming unprofitable, which condition was not met until the Supreme Court decided *Mid-La* in 1983. The defendants did not change their position because of any delay in El Paso's asserting its right to reassign. Their position is now, and has been since the execution of the GLA's, that of the owners of the overriding royalties payable by the operator of those properties assigned pursuant to the GLA's. In fact, the defendants applied for, and were granted, a temporary injunction maintaining that position during the pendency of this trial.

We hold that the trial court erred in ruling that plaintiff's claims were barred by the defense of laches.

Estoppel: The trial court did not specify in its conclusion of law, which we have quoted above, whether the estoppel that barred plaintiff's claims was equitable estoppel or collateral estoppel. We have, in our discussion of res judicata, discussed and ruled on the collateral estoppel question. We will now rule on the equitable estoppel question.

In *Gulbenkian v. Penn*, 151 Tex. 614, 252 S.W.2d 929, 932 (1952) the court said:

> On the question of estoppel we find that "In order to constitute an equitable estoppel or estoppel in pais there must exist a false representation or concealment of material facts; it must have been made with knowledge, actual or constructive, of the facts; the party to whom it was made must have been without knowledge or the means of knowledge of the real facts; it must have been made with the intention that it should be acted on; and the party to whom it was made must have relied on or acted on it to his prejudice." 31 C.J.S., Estoppel, sec. 67, page 254. Also, "Before an estoppel can be raised there must be certainty to every intent, and the facts alleged to constitute it are not to be taken by argument or

> inference. Nothing can be supplied by intendment. No one should be denied the right to set up the truth unless it is in plain contradiction of his former allegations or acts. If an act or admission is susceptible of two constructions, one of which is consistent with a right asserted by the party sought to be estopped, it forms no estoppel." Id. sec. 77, page 282, et seq.

There is no evidence in this record proving or tending to prove any one of the necessary elements required to establish equitable estoppel which would bar El Paso from recovering on its claims herein. The defendants did not meet their burden of proof.

We hold that the trial court erred in concluding that the plaintiff's claims were barred by estoppel.

Statute of Limitations: This is a suit for declaratory judgment authorized by Tex. Civ. Prac. & Rem. Code sec. 37.003 (Vernon 1986) (formerly Tex. Rev. Civ. Stat. Ann. art. 2524-1). A cause of action for declaratory judgment does not accrue until a justiciable controversy between the parties thereto arises. *California Products, Inc. v. Puretex Lemon Juice, Inc.*, 160 Tex. 586, 334 S.W.2d 780, 781 (1960). The controversy between the parties hereto with respect to the issues as to which adjudication is here sought—reassignment under the unprofitability, undeveloped acreage, and 500 Mcf clauses—arose on August 1, 1983, when El Paso undertook to reassign wells and leases pursuant to those clauses and the defendants denied El Paso's right to so reassign those wells and leases. El Paso filed this suit on the day this controversy arose, August 1, 1983.

The trial court erred in concluding that El Paso's claims are barred by the statute of limitations.

We have held that all three of the "controversial clauses" are unambiguous. That means that our construction of them are holdings of law, not of fact. *City*

of Pinehurst v. Sponer Addition Water Company, supra. However, our holding that the 500 Mcf clause does not afford El Paso a basis on which to reassign a well on a federal lease that produces less than 500 Mcf per day is not to be construed as a holding that such well may not be reassigned under any circumstances. If El Paso met the conditions imposed on it, that is, the proof of its unprofitability, and the giving of the required notice, then it could be reassigned pursuant to the unprofitability clause.

The trial court, in response to the defendant-cross-plaintiffs' prayer for injunction to enforce their claimed rights, rendered judgment for such injunction. That portion of this trial court's judgment is reversed because it imposed on El Paso duties which, we have held, it did not have. It also enforced rights of the defendant which, we have held, they do not have. We render judgment denying defendants' prayer for injunction, without prejudice, however, to defendants' right to seek and get injunctive relief should El Paso attempt, in connection with its reassignments, to exercise rights or to enforce duties inconsistent with this opinion.

The trial court also denied to plaintiff its prayed for injunctive relief to enforce its claimed construction as to its rights and duties. This action of the trial court, if error, was harmless since we have construed plaintiff's rights and duties. We assume that, upon the judgment of an appellate court becoming final and no longer appealable, the parties hereto will be guided thereby as to rights and duties relating to reassignments. We therefore decline to reverse the trial court's judgment denying El Paso's prayer for injunction and to render judgment granting plaintiff's prayer for injunctive relief. However, our ruling in this regard is without prejudice to plaintiff's right to seek and get injunctive relief should defendants fail or refuse to abide by a final judgment herein.

The trial court's judgment denied plaintiff any judgment on its claim for money damages. The plaintiff, as appellant, did not present a point of error by which it challenged the propriety of that ruling. The trial court's judgment in that respect is, therefore, affirmed.

The trial court also rendered judgment that the defendants recover from plaintiff their court costs and their attorneys fees and denying plaintiff any recovery of attorneys' fees. As to court costs, the plaintiff, as appellant, presented no point of error challenging the propriety of the trial court's ruling, and it is, therefore, affirmed.

The plaintiff, as appellant, did present points of error challenging the propriety of the trial court's awarding of attorneys' fees to defendants and denial to plaintiff any such award. However, in its brief under those points, the plaintiff made no reference to any portion of the statement of facts which supported either of them. Nor did it cite any authorities. In fact, it did not make any argument in support of them. Therefore, plaintiff waived its points of error as to attorneys' fees. Tex. R. Civ. P. 414; *Hatch v. Davis*, 621 S.W.2d 443 (Tex. Civ. App.—Corpus Christi 1981, writ ref'd, n.r.e.).

The trial court, under a section of its judgment headed "Declaratory Relief," rendered judgment declaring that plaintiff's attempted reassignments under the unprofitability clause of those GLA's which had such clause were "null, void, and without force and effect."

The judgment recited that such GLA's "do not contemplate either that the royalties payable under the terms of the GLA's or that the rates allowed plaintiff for gas produced from the GLA acreage shall be a factor in determining whether the operation of a well has become unprofitable under the terms of the unprofitability clause."

It recited that plaintiff's options to reassign a well, the operation of which has become unprofitable, "refers to marginal or non-commercial wells not producing in pay-

ing quantities, that being the correct construction of the contract."

The judgment also recited, as a part of its declaratory judgment, that a condition precedent to plaintiff's exercise of its option to reassign an unprofitable well "is obtaining any and all necessary regulatory approvals so as to allow defendants their correlative benefit of the contractual right to sell gas from any leases so conveyed to any purchaser of defendants' choosing."

Another recited condition to plaintiff's exercise of its option to reassign pursuant to the unprofitability clause was the tendering by plaintiff to defendants of a gas purchase contract in which plaintiff agreed to buy gas at the terms set forth in the unprofitability clause.

The tender by plaintiff of such a contract was wholly unnecessary because plaintiff had already, in the language of the unprofitability clause, executed and bound itself to such a contract.

Another recited condition precedent to plaintiff's exercise of its right to reassign was its duty to rid the property of all encumbrances, including encumbrances of federal regulations.

A final recitation in the court's judgment that plaintiff's "attempted" reassignments pursuant to the terms of the unprofitability clause were null, void and of no effect was that a condition to plaintiff's exercise of any right to reassign was the tendering to defendants of a gas purchase contract which allows them the option of a tailgate settlement, including 100 percent of the condensate and liquids extracted from the gas produced from the property reassigned.

We hold that all of the listed recitations were erroneous because each of them was in conflict with, or added to, the unambiguous provisions of either the unprofitability clause or the undeveloped acreage clause. *See Exxon Corporation v. Atlantic Richfield Company*, 678 S.W.2d 944, (Tex. 1984).

We reverse that portion of the trial court's judgment wherein it held the plaintiff's tendered reassignments under the unprofitability clause to be "null, void, and without force and effect" and render judgment that such tendered reassignments were valid and effectively reassigned wells and the units upon which they were located to the defendants who were the owners of the special overriding royalty relating to their production.

The judgment of the trial court denied plaintiff any right to reassign any undeveloped acreage under the provisions of GLA's 47, 52, 60, 61, 76, 77 and 78. We reverse the trial court's judgment in that respect and render judgment that the evidence herein shows, as a matter of law, that the acreage covered by those GLA's will not produce gas in commercial quantities to El Paso, and that El Paso's tender of reassignment of those acreages under those clauses was valid and effectively reassigned those acreages to the defendants who were the owners of the special overriding royalty relating thereto.

We further render judgment that, as a matter of law, those defendants to whom wells are reassigned under and pursuant to the unprofitability clause have the right to sell gas produced from those wells in accordance with the terms fixed by the language of said clause and El Paso has the obligation to buy such gas in accordance with such terms.

/s/ Bert Tunks
BERT TUNKS
Retired Justice

Justice Warren and Bass also sitting.
For Publication

Judgment rendered and opinion delivered August 7, 1986.

True copy attest:

/s/ Kathryn Cox
KATHRYN COX
Clerk of Court

COPY OF JUDGMENT

APPEAL FROM THE 11TH DISTRICT COURT
OF HARRIS COUNTY
(TR. CT. NO. 83-50539)

No. 01-84-0350-CV

EL PASO NATURAL GAS COMPANY,
Appellant

v.

AMERICAN PETROFINA COMPANY OF TEXAS, *et al.*,
Appellees

OPINION DELIVERED BY RETIRED JUSTICE TUNKS, JUSTICES WARREN AND BASS SITTING

The cause heard today by the court is an appeal from the judgment rendered and entered by the court below on February 27, 1986. After hearing the cause on the transcript of the record and inspecting the same, it is the opinion of this Court that there was no error in that part of the judgment relating to attorneys fees for the defendants. It is therefore CONSIDERED, ADJUDGED AND ORDERED that this portion of the judgment be affirmed.

It is further the opinion of this Court that there was error in the judgment except as hereinabove affirmed. It is therefore CONSIDERED, ADJUDGED, AND ORDERED that the judgment of the court below, except as hereinabove affirmed, be severed, and as severed, be reversed and rendered for appellant.

It is further ordered that the appellees, AMERICAN PETROFINA COMPANY OF TEXAS; SUSANNE LaFORCE BABER; DOUGLAS N. BARD, JAMES C. BARD; RALPH A. BARD, JR.; ROY E. BARD, JR.; ROBERT BEAMON, INDIVIDUALLY AND AS TRUSTEE; GUY R. BRAINARD, JR. TRUST; R. LEWIS CHANDLER TRUST; CHARLES W. COLWILL; CONTINENTAL ILLINOIS NATIONAL BANK & TRUST CO., TRUSTEE, TRUST NO. 23935; CONTINENTAL ILLINOIS NATIONAL BANK & TRUST CO., TRUSTEE, TRUST NO. 23949; CROWN CENTRAL PETROLEUM CORPORATION; DAVID WALLER DANGLER; ELEANOR ISHAM DUNNE; ANN HOME EMERSON, TRUSTEE; TOM L. HAIL, TRUSTEE; ALBERT L. HOPKINS, JR.; MARY C. FANNIN; CHARLES WELLS FARNHAM, JR.; ELIZABETH B. FERRINGTON; ROBERT B. FARNHAM; WALTER B. FARNHAM; F.H.N., LTD.; MINNIE A. FITTING; R.U. FITTING, JR. ESTATE; ROBERT D. FITTING; NANCY H. GERSON; CHARLES B. GRAHAM, JR.; JOHN R. GRIMES; TOM L. HAIL, TRUSTEE; RUTH N. HALLS; CORTLAND T. HILL; ELSIE F. HILL; LOUIS W. HILL, JR.; ANNA LOU HOME; TERESA HOME; H.R. STASNEY & SONS COMPANY; GEORGE S. ISHAM; HENRY P. ISHAM, JR. ESTATE; ROBERT T. ISHAM; JOSEPHINE C. JACOBSON; ROBERT J. JONES; JONES COMPANY; EULA MAE JOHNSTON; JAMES J. JOHNSTON; V.A. JOHNSTON FAMILY TRUST; NANCY LaFORCE KEYS; CASSANDRA KEYSER; JEAN E. KEYSER; BARRON KIDD; W. WATSON LaFORCE, JR.; MARTHA M. LATTNER TRUST; MARY F. LOVE; PATTIE ANN BEAMON LUNDELL; WILLIAM J. McDERMOTT, TRUSTEE; N.S. McDONALD TRUST; DAVID G. McLANE TRUST; DIXIE M. McLANE GRANDCHILDREN TRUST; WILLIAM C. McMAHAN ESTATE; MORRIS MIZEL; FLORA MIZEL; PRODUCING ROYALTIES, INC.; NORA R. RAN-

NEY; ROGERS-GIBBARD TRUST; CATHERINE H. RUML; EDWARD L. RYERSON, JR.; SABINE ROYALTY TRUST; SHAW ISHAM & CO.; JOHN I. SHAW, ET AL., TRUSTEE; JAMES SIMPSON, JR. TRUST; MICHAEL SIMPSON TRUST; PATRICIA SIMPSON TRUST; WILLIAM E. SIMPSON TRUST; SIDNEY STEIN, JR.; JOHN STUART TRUST; ROBERT DOUGLAS STUART ESTATE; SUN EXPLORATION AND PRODUCTION COMPANY; WILLIAM P. SUTTER; JUDY ST. JOHN TAYLOR; F.F. WEBSTER TRUST; HELEN ULMER VAN ATTA; KATHERINE I. WHITE; MARY S. ZICK, jointly and severally, pay all costs incurred by reason of this appeal.

It is further ordered that this decision be certified below for observance.

Judgment rendered by panel consisting of Retired Justice Tunks, Justices Warren and Bass.

APPENDIX B

COPY OF CORRECTED JUDGMENT
APPEAL FROM THE 11TH DISTRICT COURT
OF HARRIS COUNTY

Issued December 30, 1986

(TR. Ct. No. 83-50539)

No. 01-84-00350-CV

EL PASO NATURAL GAS COMPANY,
Appellant

v.

AMERICAN PETROFINA COMPANY OF TEXAS ET AL.,
Appellees

OPINION DELIVERED BY JUSTICE TUNKS,
JUSTICES WARREN AND BASS SITTING

The Court today heard appellees Tenneco Oil Company and Conoco, Inc.'s Motion for Correction of Judgment, or, in the alternative, for Rehearing, and appellees Lucerne Parties' Motion for Amendment of the Judgment of the Court and the same has been duly considered and found meritorious. It is therefore ordered that said motions be granted, and that this Court's former judgment of August 7, 1986, of record of Minute Book 21, Page 441, be, and the same hereby is, vacated, set aside, and annulled.

This cause is an appeal from the judgment rendered and entered by the court below on February 27, 1984. It is the opinion of this Court that there was no error which was preserved for appeal in that part of the judgment relating to the award of attorney's fees and costs for the defendants. It is further the opinion of this Court that there was no error in that part of the judgment relating to the attempted reassignments of leases pursu-

ant to the provisions of Article III, Section 2E of GLA 47 and the equivalent provisions of GLA's 62, 63, 66, 139, and 172. It is therefore CONSIDERED, ADJUDGED AND ORDERED that this portion of the judgment be affirmed.

It is further the opinion of this court that the portion of the trial court's judgment denying El Paso's prayer for injunction is affirmed. This portion of this judgment is without prejudice to El Paso's right to seek and be granted an injunction to enforce its rights under this judgment, should the same become necessary.

It is further the opinion of this Court that the portion of the trial court's judgment wherein it was held that the "unprofitability clause" in the GLA was ambiguous is reversed and it is here adjudged that such clause is unambiguous and entitled El Paso to reassign and lease a well upon giving of proper notice and proof of unprofitability.

It is further the opinion of this Court that the portion of the trial court's judgment where it was held that the "undeveloped acreage clause" in the GLA was ambiguous is reversed and it is here adjudged that such clause is unambiguous and entitled El Paso to reassign a lease upon giving of proper notice and proof that it would not produce in commercial quantities.

It is further the opinion of this Court that the portion of the trial court's judgment wherein it was held that in the determination of whether a lease or well was unprofitable or incapable of producing in commercial quantities the overriding royalties paid or to be paid by El Paso should not be considered a cost of operation is reversed and it is here adjudged that such overriding royalties should be considered a cost of operation.

It is further the opinion of this court that the portion of the trial court's judgment where it permanently

enjoined El Paso from interfering with the rights which it held the defendants-appellees to have and ordered El Paso to perform the duties which it held El Paso to have, is severed and reversed and it is here adjudged that such injunction is dissolved. This part of this judgment is without prejudice to the right of defendants-appellees to seek and be granted an injunction to enforce their rights under this judgment, should the same become necessary.

In the opinion heretofore filed and announced we have held that the "500 Mcf clause," contained in some of the GLA's involved does not afford El Paso a basis for reassignment of a lease or a well. However, by that opinion we also have held that if a well as to which the 500 Mcf clause was applicable became unprofitable, then it might be reassignable under the unprofitability clause. One group of defendant-appellees, the "Lucerne Group," holders of overriding royalties under the provisions of GLA 66, which does not contain either an unprofitability or an undeveloped acreage clause, has, by post-opinion motion, pointed out that the opinion may contain an inconsistency in this respect and requested that we eliminate this possible inconsistency by the form of the judgment rendered herein. We grant that request.

It is here adjudged that a well that is subject to a 500 Mcf clause, if it becomes unprofitable, may be reassigned under the unprofitability clause only if the GLA by which it was assigned contains an unprofitability clause. Since GLA 66 contains no unprofitability clause and since we have held that the 500 Mcf clause does not afford a basis for reassignment of a well or lease, the wells and leases assigned by GLA 66 are not unilaterally reassignable by El Paso.

The defendant-appellees Tenneco and Conoco are the owners of overriding royalties created by GLA's 47, 52, and 60. They have entered into a settlement agreement with El Paso as to the issues relating to those GLA's and

they and El Paso have filed a joint motion to dismiss the appeal insofar as it relates to those settled issues. In our opinion we have held that El Paso's tendered reassignment of wells and leases under those GLA's was valid and effected a reassignment of those wells and leases. The movants contend that the language of our opinion as to the effectiveness of El Paso's tendered reassignment creates a conflict between this court's opinion and their settlement agreement and have asked that we amend our opinion as to those recitations concerning those GLA's. This we decline to do. We do, however, here adjudge that, insofar as the rights and/or duties fixed by this judgment conflict with any valid settlement agreement between the parties hereto, the settlement agreement prevails.

The trial court failed to rule on the issue as to whether, in the event of El Paso's reassignment of a well under and pursuant to the unprofitability clause, the one to whom it was so reassigned would have a contractual right to sell the production from such well to El Paso "at the price paid for gas of like kind and quality in the field by El Paso or any other bona fide pipeline company, and El Paso agrees to purchase such gas at such price." (The language within the quotation marks is taken, verbatim from the unprofitability clause.) It is, therefore, here adjudged that such a reassignee has a contractual right to sell the production from such reassigned well to El Paso and that El Paso is contractually obligated to pay therefore at the price prescribed by the quoted language of the unprofitability clause.

It is further the opinion of this Court that there was error in the judgment except as hereinabove affirmed. It is therefore CONSIDERED, ADJUDGED, AND ORDERED that the judgment of the court below, except as hereinabove affirmed, be severed, and as severed, be reversed and rendered for appellant.

It is further ordered that all costs incurred by reason of this appeal be taxed as they were incurred by each party.

It is further ordered that this decision be certified below for observance.

Judgment rendered by panel consisting of Retired Justice Tunks, Justices Warren and Bass.

APPENDIX C

IN THE SUPREME COURT OF TEXAS

No. C-6143

July 8, 1987

FINA OIL AND CHEMICAL COMPANY, *et al.*

vs.

EL PASO NATURAL GAS COMPANY

From Harris County, First District

Application on behalf of Fina Oil and Chemical Company et al., together with amendment to application and supplemental memorandums in support of application on behalf of Fina Oil and Chemical Company et al., and application on behalf of El Paso Natural Gas Company, together with supplement to application on behalf of El Paso Natural Gas Company, for writs of error to the Court of Appeals for the First Supreme Judicial District having been duly considered, and the Court having determined that the applications, as amended and supplemented, present no error requiring reversal of the judgment of the Court of Appeals, it is ordered that said ap-

plications, as amended and supplemented, be, and hereby are, refused.

It is further ordered that applicants, Fina Oil and Chemical Company et al., and applicant, El Paso Natural Gas Company, pay all costs incurred on each respective application.

APPENDIX D

IN THE SUPREME COURT OF TEXAS

No. C-6143

September 16, 1987

FINA OIL AND CHEMICAL COMPANY, *et al.*

vs.

EL PASO NATURAL GAS COMPANY

From Harris County, First District

JUDGMENT

Motions for rehearing of applications for writ of error having been duly considered, it is ordered that said motions be, and hereby are, overruled. (Chief Justice Hill not sitting).

I, MARY M. WAKEFIELD, Clerk of the Supreme Court of Texas, do hereby certify that the above and foregoing is a true and correct copy of the orders of the Supreme Court of Texas in the case numbered and styled as above, as the same appears of record in the minutes of said Court under the dates shown.

WITNESS my hand and seal of the Supreme Court of Texas, at the City of Austin, this, the 16th day of September, 1987.

MARY M. WAKEFIELD
Clerk

By /s/ Blanca E. Morin
BLANCA E. MORIN
Deputy

APPENDIX E

IN THE DISTRICT COURT OF
HARRIS COUNTY, TEXAS
11TH JUDICIAL DISTRICT

No. 83-50539

EL PASO NATURAL GAS COMPANY
v.
TENNECO OIL COMPANY, *et al.*

MEMORANDUM OPINION

Before rendering decision, the Court thanks all counsel in this case for their dedication, thorough preparation, and advocacy in behalf of their clients. From the temporary injunction hearing in September 1983 throughout the lengthy presentation of testimony and introduction of exhibits from November 28, 1983 to February 10, 1984, neither rain, nor sleet, nor gloom of night (nor even pregnancy) stayed these advocates from their appointed duties.* The quality of legal work on both sides was so high as to make any decision difficult.

Upon consideration of the evidence adduced during trial of this cause, together with the arguments and briefs of counsel, it is the Court's opinion that plaintiff, El Paso Natural Gas, has failed to prove that it is entitled to a declaratory judgment as requested. The various properties should not have been unilaterally reassigned by plaintiff to the defendant GLA overriding royalty owners, Tenneco Oil Company, et al.

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* With apologies to the U.S. Postal Department.

In support of this opinion, the following are some (but not all) of the findings of fact and conclusions of the court:

A. *The "Unprofitability" Clause.*

1. The "unprofitability" clause, (Article VI, Section 2 of the GLA's), in the context of the agreed development program, was intended as a type of "*marginal*" or "*commercial*" well clause. It was not intended to permit El Paso to reassign a well and its unit unless the operation of the well failed to produce gas in commercial or paying quantities.

Article VI, Section 2 has three parts:

First, the assigned land was to be divided into drilling units of 320 acres, and El Paso was to drill a well for oil and gas on each unit to the Mesa Verde formation;

Second, in event it should become evident that any unit would not be productive of gas in commercial quantities, El Paso was given the option to reassign the unit to the GLA owner, and thereafter be relieved of obligation to drill any well thereon; provided, that El Paso could retain any commercial gas well thereon completed in a shallower or deeper formation;

Third, in event the operation of any well now or hereafter drilled should become "unprofitable," then El Paso, upon 60 days notice to the GLA owner would have the option to reassign the well to the GLA owners and such owners would have the right to sell gas produced therefrom to El Paso at the highest price it pays for similar gas, or to any other bona fide pipeline company, and El Paso agreed to buy at such price.

2. The parties clearly understood that in the unique field of the San Juan Basin of New Mexico some wells might fail to produce in commercial or profitable quantities, just as it might quickly become evident that as to some units drilling would not be commercially productive

thereon. The word "unprofitable" was not used as a word of art; it was used solely in the context of the development program. It should not be construed to allow the unilateral reassignment of a well and its unit which is producing, or capable of producing, gas in commercial quantities simply because El Paso has pricing problems. The special overriding royalties should not be considered in determining the "profitability" of the operation of such well. Garcia v. King, 164 S.W.2d 509, 512 (Tex. 1942); Clifton v. Koontz, 325 S.W.2d 684 (Tex. 1959).

3. If the clause is ambiguous, then the testimony of Paul Kayser (original head of El Paso) on May 5, 1952, before the Federal Power Commission, is persuasive. He testified as follows (pages 513-514, Defendant Tenneco's Exhibit No. 153):

> "Q Under the contract, Mr. Kayser, the El Paso Company agrees to develop a program of this land; they are going to drill the wells and pay the royalty, is that correct?
>
> "A (Kayser) That is right. What we did, we did not pay anything for the leases; we bought wells that were on the property at a considerable—at an agreed valuation: $80,000 for Mesa Verde wells and $30,000 for Picture Cliff wells, and then we agreed to go ahead and develop it over a five-year period on the basis of 320 acres per well: *We have the right, if in our judgment, a given 320 is not worthy to be drilled, we turn it back; if it turns out to be noncommercial, we again turn it back.*" (Emphasis mine.)

Mr. Kayser's interpretation in 1952 is a masterful shorthand rendition of the entire second section of Article VI. He seemed to have no doubt whatever that the word "unprofitable" was a synonym for "non-commercial". The remainder of his testimony emphasizes such initial interpretation of the contract.

Further, the April, 1965, summary and history of the GLA contract by Tenneco's Millard Carr, (Defendant Tenneco's Exhibit No. 155, Page 5)—although a self-serving statement—indicates a longtime, continuous and mutual interpretation of the "unprofitability" clause:

> "*Marginal wells* (Article VI, Section 2) may be re-assigned to Delhi at El Paso's option. In such event Delhi can sell the gas to El Paso at the highest field price." (Emphasis his.)

Again, this is a shorthand rendition which indicates the parties intended the word "unprofitable" to equate with "marginal" or "noncommercial". The amount of special overriding royalties, or the difficulties of pricing the gas need not be considered in determining the profitability of the operation of a well.

4. Probably the language of the 1974 settlement agreement could be construed to prevent El Paso from attempting to use the "unprofitability clause" to reassign the properties based on any FERC ruling that El Paso can no longer "pass through" the special overriding royalties as a "cost of service" in its rates to customers.

It is unfortunate that El Paso by filing a new rate schedule with the FERC, which abandoned the "cost of services" approach, created a risk that its new rates might not be such as to cover the burden of the special overriding royalties. It was a calculated business risk, however, and no basis for equitable relief to El Paso. He who seeks equity must do equity. El Paso has failed to meet this test.

5. Possibly the defense of *res judicata* may apply with regard to the "Midland" case of *El Paso v. Sun Oil, Et Al,* 426 F.Supp. 963, Affd, 700 F(2d) 1011 (5th U.S. Circ.) in the Federal District Court. The interpretation which El Paso now makes of the "unprofitability" and "500 MCF" clauses could have been made at the time of such trial as easily as they are now being made. Perhaps

they were not urged then as alternative claims by El Paso, either because it expected to win on its principal claim that the GLAs amounted to gas sales contracts, or because the wells were not "unprofitable" in the context of El Paso's rate-making approach. The Court is inclined to find that *res judicata* bars El Paso from attempting to convert the royalty owners into working interest owners on the basis of its interpretation of the "unprofitability" and "500 MCF" clauses.

B. The "500 MCF" Clause.

El Paso has failed to establish that the so-called "500 MCF" clause (e.g., as is contained in GLA 63, Article III, Section 2, Paragraph E) automatically entitles Plaintiff to convey its working interest to relevant GLA owners whenever the production falls below 500 MCF per well per day on a monthly basis. Nothing whatever is mentioned in the clause as to any such conveyancing effect. None of the parties have so interpreted the clause for more than thirty years throughout its existence.

2. The "500 MCF" clause was used in the contract simply to avoid the effect of a Department of the Interior provision by changing the nomenclature of the payment of royalties. In effect, it was intended as an accounting device and not as a basis for instant reversion of title whenever production fell below 500 MCF.

3. If the interpretation now urged by El Paso to this clause were correct, then the status of the subject properties for the past thirty years as to title, taxes, and other provisions would indeed be chaotic. El Paso concedes that ever since 1973, production on many of the GLA properties was less than 500 MCF per well per day. Yet no attempt was made by El Paso to reassign or convert the royalty interests. Further, El Paso could have urged this interpretation as an alternative claim in the lawsuit between it and defendants in the Midland Federal District Court and in the appeal of same to the 5th U.S.

Circuit Court. Its failure to do so possibly establishes a *res judicata* defense, as previously noted.

4. In the 1974 settlements between the parties, it would appear that in all probability it was intended that the "500 MCF" clause should not thereafter have been used to avoid the payment of the overriding royalties. Thus, the parties are foreclosed by such settlement from litigating that which had been agreed upon.

5. The Court believes the "500 MCF" clause is not ambiguous and should not be construed to permit El Paso to make unilateral reassignment of working interests to Defendants without first seeking abandonment of the wells in question, or without proceeding to arbitration. If the clause is ambiguous, however, then the testimony of Plaintiff's witnesses, including Mr. James Permenter, et al., indicates that the real purpose of the clause was to avoid the Department of Interior provision and was not intended as an automatic reversionary clause.

Conclusion.

The Court denies Plaintiff's petition for declaratory judgment and grants Defendants' counterclaims for declaratory judgment. The assessment of costs and attorneys' fees will be in accordance with stipulated facts, but the Court prefers to give further instructions in that respect at a later date. Counsel is requested to submit proposed judgment consistent with this Memorandum Opinion. The Opinion itself is not a final judgment and should not be used to calculate any appellate procedures.

The Court will also entertain proposed findings of fact and conclusions of law by all parties and will set a date for consideration of same promptly after signing final judgment.

February 15, 1984.

/s/ Wm. N. Blanton, Jr.
WM. N. BLANTON, JR.
District Judge

Re: No. 83-50539 *El Paso Natural Gas vs. Tenneco Oil Co.*

(To be attached to Memorandum Opinion as a guide to additional findings)

SUBSIDIARY FACTS AND CONCLUSIONS

1. The "just and reasonable" rate question is interesting but not determinative. The Court believes that the F.E.R.C., by approving El Paso's rates (which included the special overriding royalties as *prudent and reasonable*) did establish a just and reasonable rate. Otherwise, under federal law, El Paso has been guilty of criminal acts in selling its gas at rates not "just and reasonable."

2. The Mid-Louisiana decision is also interesting but not determinative. This Court does not believe that such decision compels El Paso to abandon its "cost of service" approach which it had been enjoying in its rate schedules. The "Mid-La" decision likely opened a new vista to El Paso whereby it could increase its non-GLA production prices and decrease its GLA production prices, taking the risk that it could also reassign all GLA properties and thereby eliminate the costly (but prudent and reasonable) overriding royalties.

3. Whether El Paso applies to the F.E.R.C. for special relief (allowing "cost of service" in setting its rates) is up to El Paso. Under this Court's interpretation of the clauses it makes no difference whether a prudent operator would be required to apply for such governmental action or not. Texas courts appear to be divided on this point, although some of the appellate decisions cited appear to require such action.

4. El Paso urges that recent complaints by its customers challenging past "cost of service" treatment raises the specter of refunds. It therefore contends that this

Court should allow reassignment of the GLA's to protect El Paso against the risk of such refunds. To the contrary, perhaps this Court's refusal to permit El Paso to avoid its GLA obligations may convince the F.E.R.C. that it was correct in previously allowing the "cost of service" approach in setting rate schedules, and thereby deny any demands for refunds.

5. This Court agrees with El Paso that the clauses at issue in this case should not be deemed *forfeiture* or *reversionary* provisions.

6. This Court agrees with El Paso that the clauses do not expressly require El Paso to obtain *abandonment* prior to reassignment. On the other hand, if El Paso believes that a fair and equitable interpretation of the GLA clauses permits optional reassignment for El Paso's benefit, just because the F.E.R.C. does not now permit the "passing through" of "cost of service," then El Paso has an equitable responsibility to seek abandonment or other certification of the wells for defendants' corresponding benefit (if any). El Paso has at no time offered to assist defendants in obtaining abandonment of the wells.

It is noted that in connection with the settlement of this case between Union Oil Company and El Paso, the latter has agreed to assist Union to obtain F.E.R.C. assistance; otherwise, the settlement is to be void.

7. This Court agrees with Defendant Tenneco that in no event can El Paso invoke the "unprofitability" clause for its benefit unless and until defendants are given the benefit of their end of the bargain. That is, defendants must be given all of the gas at the tailgate of the plant and the extracted liquids free and clear of any federal requirements and encumbrances.

8. As to the unprofitability studies of El Paso, this Court agrees with defendants that El Paso has failed to account properly for all revenues and has claimed deductions that are not proper.

9. This Court questions whether El Paso has assigned correct values to the GLA production studies. It should not have included return on investment, taxes, or overriding royalties in determining profitability.

10. It is true that El Paso's pipeline production was made subject to federal price ceilings by the N.G.P.A. of 1978. But this Court does not believe that the parties intended the "unprofitability" clause to be tied to pricing. If a change in pricing as allowed by the F.P.C. or F.E.R.C. were to govern the question of whether the overriding royalties were to be paid, then the 1974 settlement settled that question. Other than a federal government ruling that the GLAs constituted sales contracts (which ruling never occurred) El Paso agreed to pay the royalties, *period*. Its chairman, Mr. Petty, so acknowledged in his testimony.

The *GLOSSARY OF TERMS* should be made a part of these findings and conclusions for reference.

APPENDIX F

IN THE DISTRICT COURT OF
HARRIS COUNTY, TEXAS
11TH JUDICIAL DISTRICT

No. 83-50539

April 30, 1984

EL PASO NATURAL GAS COMPANY

v.

TENNECO OIL COMPANY, *et al.*

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On November 28, 1983, the above captioned cause came on for trial before the Court without a jury. On February 27, 1984, after considering the pleadings, evidence, arguments and briefs, the Court signed its written Judgment in favor of Defendants on all issues and recited therein certain findings of fact and conclusions of law. At Plaintiff's request, the Court hereby makes its further findings of fact and conclusions of law as follows:

FINDINGS OF FACT

* * * *

104. Plaintiff has indicated in publicly filed documents and/or in internal studies that it contemplates an increase in corporate profits based upon its proposed form of implementation of *Mid-Louisiana* compared to continued cost of service pricing of $3.8 billion over the next

twenty years, $4.6 billion if the GLA properties are reassigned.

* * * *

SIGNED this 30th day of April, 1984.

/s/ William N. Blanton, Jr.
WILLIAM N. BLANTON, JR.
District Judge

APPENDIX G

SETTLEMENT AGREEMENT

THIS AGREEMENT is made this 29th day of October, 1974, by and between EL PASO NATURAL GAS COMPANY (hereinafter sometimes referred to as El Paso) and AMERICAN PETROFINA COMPANY OF TEXAS, TENNECO OIL COMPANY and CONTINENTAL OIL COMPANY (hereinafter sometimes referred to as Petrofina et al.).

WITNESSETH:

WHEREAS, El Paso entered into an Oil and Gas Lease Sale Agreement with Three States Natural Gas Company et al. on July 8, 1953, under which El Paso acquired from Three States et al. certain of their right, title and interest in certain oil and gas leases located in the San Juan Basin of New Mexico, subject to the reservation by Three States et al. of an interest denominated as an "overriding royalty interest" (the said Oil and Gas Lease Sale Agreement is hereinafter sometimes referred to as the agreement or as GLA 78); and

WHEREAS, Petrofina et al. have succeeded to the interests of Three States et al. under the agreement; and

WHEREAS, the agreement required El Paso to pay an overriding royalty on gas at an initial amount of five (5¢) cents per Mcf, escalating to ten (10¢) cents per Mcf, and required El Paso to pay such overriding royalty at such amount as would be redetermined for each successive five-year period beginning July 27, 1968; that the overriding royalty to be paid during each such five-year period was to be determined by agreement, if possible, or by arbitration if agreement could not be reached; that El Paso also was required to pay a higher overriding royalty pursuant to a "favored nations" clause contained in the agreement; and

WHEREAS, Sun Oil Company (Delaware), the owner of an overriding royalty interest under a similar agreement, upon being unable to agree with El Paso as to the amount of its overriding royalty interest for the five-year period beginning January 5, 1973, obtained an arbitration award establishing the overriding royalty at forty (40¢) cents per Mcf for such five-year period; and

WHEREAS, Petrofina et al. have demanded determination of the amount of the overriding royalty payable by El Paso under GLA 78 for the five-year period commencing July 27, 1973, and, upon failing to agree with El Paso as to the applicable amount, has demanded that such amount be determined by arbitration; and

WHEREAS, in view of the arbitration award establishing an overriding royalty of forty (40¢) cents per Mcf payable to Sun Oil Company, and in view of the increasing prices being paid for natural gas and other forms of energy throughout the United States, the parties recognize the probability that arbitration concerning GLA 78 will result in an overriding royalty of not less than forty (40¢) cents per Mcf which El Paso would be required to pay to Petrofina et al. for the five-year period commencing July 27, 1973; and

WHEREAS, Petrofina et al. assert that the arbitration award in the Sun proceeding will "trigger" the "favored nations" clause in the agreement and result in an overriding royalty of forty (40¢) cents per Mcf payable thereunder from January 5, 1973; regardless of the outcome of the arbitration proceedings under GLA 78; and

WHEREAS, El Paso has been hindered in obtaining rate relief from the Federal Power Commission covering its liability under GLA 78 and other similar agreements because the amount of El Paso's liability has not been finally determined and increased amounts above the level of ten (10¢) cents per Mcf have not been paid; and

WHEREAS, the parties are desirous of avoiding further disputes and further arbitration proceedings and to set at rest the issue in pending litigation and arbitration to determine the applicable overriding royalty to be paid by El Paso to Petrofina et al. both now and in the future, without however disposing of any other issues in such pending litigation.

NOW, THEREFORE, the parties agree as follows:

1. The parties agree that the overriding royalty on gas payable by El Paso to Petrofina et al. under GLA 78 shall be ten (10¢) cents per Mcf for the period January 5, 1973, through May 31, 1974, and forty (40¢) cents per Mcf on June 1, 1974, and continuing thereafter until such overriding royalty is increased as provided herein. The overriding royalty payable under GLA 78 shall never on or after June 1, 1974, be less than forty (40¢) cents per Mcf.

2. On June 1, 1975, and on June 1 of each succeeding year, the amount of the overriding royalty on such gas payable for the ensuing twelve-month period shall be a rate per Mcf equal to the highest rate prescribed or permitted by the Federal Power Commission (or by any successor Federal agency having authority to review or establish rates for natural gas flowing in interstate commerce) for natural gas flowing in interstate commerce from any area in which El Paso's lower forty-eight states interstate pipeline system is then situated, less seven (7) cents per Mcf; provided, however, that in determining such highest rate, only those rates of general applicability which are prescribed or permitted with respect to sales of gas at the wellhead shall be considered, and there shall be excluded from consideration any rates prescribed or permitted with respect to sales made pursuant to (i) contracts with small producers, (ii) contracts for emergency sales, (iii) contracts having a term of less than one year, and (iv) contracts made in accordance with Federal Power Commission Orders 455-455A. There also

shall be excluded from consideration rates prescribed or permitted by the Federal Power Commission (i) pursuant to a producer's petition for special relief, (ii) payable under unilateral producer filings, (iii) payable for liquefied natural gas, in liquid or regasified state, and (iv) payable for synthetic gas, even if it be defined as natural gas.

Such highest rate shall be determined consistent with the forty-two (42¢) cent base rate specified in Federal Power Commission Opinion No. 699, excluding any adjustments for gathering allowance and for production, severance and similar taxes. Prior to the seven cent deduction, such highest rate shall be adjusted to a pressure base of 15.025 psia and from a BTU base of 1000 per cubic foot adjusted to the weighted average BTU content of the residue gas at the outlet of El Paso's Chaco, Blanco and San Juan River processing plants (which for purposes of this agreement shall never be less than 1050 BTU per cubic foot) for the twelve-month period immediately preceding the June 1 date for determination of the rate.

The highest rate provided for herein shall be the rate specified in any applicable order of the Federal Power Commission (or successor agency) which rate is in effect on June 1 of each year, regardless of the pendency of an appeal with respect thereto, unless a stay order has been entered, and no subsequent modification of the said orders either increasing or decreasing rates shall effect a modification of such rate until the end of the annual period during which such modification occurred.

3. Once the price of "new" natural gas flowing in interstate commerce ceases to be subject to price regulation by the Federal Power Commission (or any successor agency), the parties agree that, in lieu of the amount specified in paragraph 2. above, the amount of the overriding royalty on gas which shall be effective on June 1

of each year shall be a rate per Mcf equal to the average of the three highest wellhead rates provided in separate contracts payable by El Paso for gas being delivered on April 1 of such year for gas flowing in interstate commerce from any area in which El Paso's lower forty-eight states interstate pipeline system is then situated, less seven (7¢) cents per Mcf; provided, however, in determining the average rate there shall be excluded from consideration any rates (i) prescribed in contracts having a term of less than one year, or (ii) payable for liquefied natural gas in liquid or regasified state, or (iii) payable for synthetic gas, even if it be defined as natural gas, or (iv) set forth in contracts for direct sales from another pipeline.

In determining the three highest rates, appropriate adjustment shall be made for contract variances, which adjustment shall include, but not necessarily be limited to, consideration of such factors as (i) BTU, (ii) pressure base, (iii) gathering allowance (if delivery point is other than the wellhead), (iv) compression allowances, and (v) taxes. Prior to the seven cent deduction, such average rate shall be adjusted to a pressure base of 15.025 psia and from a BTU base of 1000 per cubic foot adjusted to the weighted average BTU content of the residue gas at the outlet of El Paso's Chaco, Blanco and San Juan River processing plants (which for purposes of this agreement shall never be less than 1050 BTU per cubic foot) for the twelve-month period immediately preceding the April 1 date for determination of the rate.

4. The parties agree that Article XII and Article III, Section 2, Paragraph C, of GLA 78, are hereby suspended only so long as Petrofina et al. are receiving payment for their overriding royalty in the manner specified in this agreement. In the event of a disagreement or controversy over any provision of this settlement agreement or the application or determination of any rate thereunder, the parties agree that the arbitration provisions of GLA 78 shall not apply.

5. In the event GLA 78 shall be finally determined in a proceeding in which Petrofina et al. are parties to be a sale for resale in interstate commerce and to be subject to the jurisdiction of the Federal Power Commission, the final orders of the Commission shall govern El Paso's obligation to make payment to Petrofina et al. as set forth in this agreement. El Paso agrees, notwithstanding any order of the Federal Power Commission other than an order based on a final determination that GLA 78 is a jurisdictional sale for resale, to make payment as provided hereunder. A final determination shall mean one which is no longer subject to appeal or review by the court of last resort having jurisdiction of the subject matter.

6. El Paso agrees to make payment for all arrearages under GLA 78 within ten (10) days from the date of execution of this agreement.

7. This agreement contains the complete understanding of the parties hereto concerning the subject matter hereof.

8. This agreement shall be binding upon the parties hereto, and their successors in interest.

IN WITNESS WHEREOF, the parties have executed this agreement on the date set forth above.

ATTEST:

EL PASO NATURAL GAS COMPANY

/s/ [Illegible]
Assistant Secretary

By /s/ Travis Petty
TRAVIS PETTY
Executive Vice President

ATTEST:

AMERICAN PETROFINA COMPANY OF TEXAS

/s/ W. A. Schneeberg
Assistant Secretary

By /s/ R. B. Wilkins
Vice President

ATTEST:

/s/ Wm. Armstrong
Assistant Secretary

TENNECO OIL COMPANY

By /s/ Vernon M. Turner
Vice President

CONTINENTAL OIL COMPANY

By /s/ Robert W. Lee
Agent and Attorney-in-Fact

STATE OF TEXAS)
) ss.
COUNTY OF HARRIS)

Before me, the undersigned authority, on this day personally appeared TRAVIS PETTY, Executive Vice President of El Paso Natural Gas Company, known to me to be the person and officer whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed and in the capacity therein stated as the act and deed of said Company.

Given under my hand and seal of office, this 29th day of October, 1974.

/s/ Betty Graham
BETTY GRAHAM
Notary Public in and for
Harris County, Texas

My Commission Expires June 1, 1975

STATE OF TEXAS)
) ss.
COUNTY OF HARRIS)

Before me, the undersigned authority, on this day personally appeared R. B. Wilkins, Vice President of American Petrofina Company of Texas, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity therein stated, and as the act and deed of said corporation.

Given under my hand and seal of office this 29th day of October, 1974.

/s/ Betty Graham
BETTY GRAHAM
Notary Public in and for
Harris County, Texas

My Commission Expires June 1, 1975

STATE OF TEXAS)
) ss.
COUNTY OF HARRIS)

Before me, the undersigned authority, on this day personally appeared Vernon M. Turner, Vice President of Tenneco Oil Company, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity therein stated, and as the act and deed of said corporation.

Given under my hand and seal of office this 29th day of October, 1974.

/s/ Betty Graham
BETTY GRAHAM
Notary Public in and for
Harris County, Texas

My Commission Expires June 1, 1975

STATE OF TEXAS)
) ss.
COUNTY OF HARRIS)

Before me, the undersigned authority, on this day personally appeared Robert W. Lee, Agent and Attorney in Fact for Continental Oil Company, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity therein stated, and as the act and deed of said corporation.

Given under my hand and seal of office this 29th day of October, 1974.

/s/ Betty Graham
BETTY GRAHAM
Notary Public in and for
Harris County, Texas

My Commission Expires June 1, 1975

APPENDIX H

LIST OF DEFENDANTS/APPELLEES IN THE TEXAS COURT OF APPEALS

American Petrofina Company of Texas
Atlantic Richfield Company
Susanne LaForce Baber
Douglas N. Bard
James C. Bard
Ralph A. Bard, Jr.
Roy E. Bard, Jr.
Robert Beamon
Robert Beamon, Trustee
Guy R. Brainard, Jr. Trust
R. Lewis Chandler Trust
Charles W. Colwell
Conoco Inc.
Continental Illinois National Bank
& Trust Co., Trustee, Trust No. 23935
Continental Illinois National Bank
& Trust Co., Trustee, Trust No. 23949
Crown Central Petroleum Corporation
David Waller Dangler
Eleanor Isham Dunne
Anne Home Emerson, Trustee
Tom L. Hail, Trustee
Albert L. Hopkins, Jr.
Mary C. Fannin
Charles Wells Farnham
Elizabeth B. Ferrington
Robert B. Farnham
Walter B. Farnham
F.H.N., Ltd.
Minnie A. Fitting
R. U. Fitting, Jr. Estate
Robert D. Fitting
Nancy H. Gerson

Charles E. Graham, Jr.
John R. Grimes
Ruth N. Halls
Cortland T. Hill
Elsie F. Hill
Louis W. Hill, Jr.
Anna Lou Home
Teresa Home
H. R. Stasney & Sons Company
George S. Isham
Henry P. Isham, Jr. Estate
Robert T. Isham
Josephine C. Jacobson
Robert J. Jones
Jones Company
Eula Mae Johnston
James J. Johnston
V. A. Johnston Family Trust
Nancy LaForce Keys
Cassandra Keyser
Jean E. Keyser
Barron Kidd
W. Watson LaForce, Jr.
Martha M. Lattner Trust
Mary F. Love
Pattie Ann Beamon Lundell
William J. McDermott, Trustee
N. S. McDonald Trust
David G. McLane Trust
Dixie M. McLane Grandchildren Trust
William C. McMahan Estate
Morris Mizel
Producing Royalties, Inc.
Nora R. Ranney
Rogers-Gibbard Trust
Catherine H. Ruml
Edward L. Ryerson, Jr.
Sabine Royalty Trust

Shaw Isham & Co.
John I. Shaw, et al., Trustee
James Simpson, Jr. Trust
Michael Simpson Trust
Patricia Simpson Trust
William E. Simpson Trust
Sidney Stein, Jr.
John Stuart Trust
Robert Douglas Stuart Estate
Sun Exploration and Production Company
William P. Sutter
Judy St. John Taylor
Tenneco Oil Company
F. F. Webster Trust
Helen Ulmer Van Atta
Katherine I. White
Mary S. Zick

LIST OF PETITIONERS FOR WRIT OF ERROR IN THE SUPREME COURT OF TEXAS

Fina Oil and Chemical Company
Morris Mizel
Flora Mizel
Barron Kidd
Helen Ulmer Van Atta
Charles W. Colwill
Anne Home Emerson, Trustee
Anna Lou Home
Teresa Home
Jean E. Keyser
Cassandra Keyser
Sun Exploration and Production Company
Robert Beamon, Individually and as Trustee
Thomas L. Hail, Trustee
Pattie Ann Beamon Lundell
The Jones Company
H. R. Stasney & Sons Company
William C. McMahan Estate

LIST OF RESPONDENTS IN THE SUPREME COURT OF TEXAS

American Petrofina Company of Texas
Charles W. Colwill
Anne Home Emerson, Trustee
Anna Lou Home
Jean E. Keyser
Cassandra Keyser
Barron Kidd
Teresa Home
Helen Ulmer Van Atta
Sun Exploration and Production Co.
F.H.N., Ltd.

Continental Illinois National Bank & Trust Co., Trustee, Trust No. 23935
Continental Illinois National Bank & Trust Co., Trustee, Trust No. 23949
David Waller Dangler
Eleanor Isham Dunne
Estate of Henry P. Isham, Jr.
Robert T. Isham
Martha M. Lattner Trust
N. S. McDonald Trust
Mary F. Love
William J. McDermott, Trustee
Shaw Isham & Co.
John I. Shaw, *et al.*, Trustee
James Simpson, Jr. Trust
William E. Simpson Trust
John Stuart Trust
Estate of Robert Douglas Stuart
Michael Simpson Trust
Patricia Simpson Trust
Katherine I. White
Jones Company
Estate of William C. McMahan
H. R. Stasney & Sons Company
Robert Beamon
Robert Beamon, Trustee
Tom L. Hail, Trustee
Ann Beamon Lundell
Morris Mizel
Flora Mizel
James A. and Hazel N. Borland
David G. McLane Trust
Dixie M. McLane Grandchildren Trust
Producing Royalties, Inc.
Judy St. John Taylor
Crown Central Petroleum Corporation

APPENDIX 1

SECTION 104 OF THE NATURAL GAS POLICY ACT OF 1978, 15 U.S.C. § 3314

CEILING PRICE FOR SALES OF NATURAL GAS DEDICATED TO INTERSTATE COMMERCE.

(a) APPLICATION.—In the case of natural gas committed or dedicated to interstate commerce on the day before the date of the enactment of this Act and for which a just and reasonable rate under the Natural Gas Act was in effect on such date for the first sale of such natural gas, the maximum lawful price computed under subsection (b) shall apply to any first sale of such natural gas delivered during any month.

(b) MAXIMUM LAWFUL PRICE.—

(1) GENERAL RULE.—The maximum lawful price under this section for any month shall be the higher of—

(A) (i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or

(B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before the date of the enactment of this Act and which is applicable to such natural gas.

(2) CEILING PRICES MAY BE INCREASED IF JUST AND REASONABLE.—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

Supreme Court, U.S.
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No. 87-985

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FINA OIL AND CHEMICAL COMPANY, *et al*,

Petitioners,

v.

EL PASO NATURAL GAS COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF APPEALS FOR THE
FIRST SUPREME JUDICIAL DISTRICT OF TEXAS

RESPONDENT'S BRIEF IN OPPOSITION

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RULE 28.1 LISTING

The following is a list of all parent companies, subsidiaries and affiliates (except wholly-owned subsidiaries) of El Paso Natural Gas Company:

Burlington Northern Inc.
- BN Financial Services Inc.
- BN Geothermal Inc.
- BN Leasing Inc.
- Burlington Northern Foundation
- Burlington Northern International Services Inc.
- Burlington Northern Motor Carriers Inc.
- Burlington Northern Overseas Finance Company N.V.
- Burlington Northern Railroad Company
  - The Belt Railway Company of Chicago
  - Camas Prairie Railroad Company
  - Davenport, Rock Island and North Western Railway Company
  - The Denver Union Terminal Railway Company
  - Houston Belt & Terminal Railway Company
  - Iowa Transfer Railway Company
  - Kansas City Terminal Railway Company
  - Keokuk Union Depot Company
  - The Lake Superior Terminal and Transfer Railway Company
  - Longview Switching Company
  - M T Properties, Inc.
  - Paducah & Illinois Railroad Company
  - Portland Terminal Railroad Company
  - Terminal Railroad Association of St. Louis
  - Trailer Train Company
  - The Wichita Union Terminal Railway Company
- CBR Distribution Corporation
- Colt Intermodal Inc.
- Glacier Park Company
- Glacier Park Liquidating Company
- Meridian Minerals Company

M-R Holdings Inc.
National Exchange, Inc.
New Mexico and Arizona Land Company
Plum Creek Timber Company, Inc.
Research Applications Inc.
The El Paso Company
  Meridian Oil Holding Inc.
    Meridian Oil Inc.
      Butte Pipe Line Company
      Portal Pipe Line Company

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RESPONDENT'S BRIEF IN OPPOSITION

The Respondent, El Paso Natural Gas Company (hereinafter "Respondent"), respectfully requests that this Court deny the petition for writ of certiorari, seeking review of the Court of Appeals for the First Supreme Judicial District of Texas' ("Texas Court of Appeals") judgment in this case. The opinion of the Texas Court of Appeals is reported at 733 S.W.2d 541 (Tex. App.-Houston [1st Dist.] 1986, writ ref'd n.r.e.).

I.
JURISDICTION

As demonstrated in the opinion of the Texas Court of Appeals, the judgment was based solely on state law grounds. The dispositive issue in the Texas Court of Appeals was whether Respondent was entitled to reconvey natural

gas wells and acreage to Petitioners[1] in accordance with the express terms of gas lease-sales agreements between the parties. The court, without deciding any questions of federal law, simply construed the gas lease-sales agreements according to principles of contract interpretation and state oil and gas law. This Court, therefore, lacks jurisdiction under 28 U.S.C. § 1257 (1982) to grant Petitioners' application, or to review the decision of the Texas Court of Appeals.

II.
STATUTE INVOLVED

The judgment of the Texas Court of Appeals did not draw into question any federal statute. The court's discussion of § 104 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3314 (1982), assumed the validity of that Act, and was included in the court's opinion for the purpose of explaining the procedural and factual history of the case. The court's holding, that Respondent had no duty to keep the gas wells in question profitable, did not involve the interpretation of any federal statute.

III.
STATEMENT OF FACTS

The relevant facts are fully set forth in the opinion of the Texas Court of Appeals and in the opinion of the Fifth Circuit Court of Appeals in *El Paso Natural Gas Co.* v. *Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983), *cert. denied*, 468 U.S. 1219 (1984). The facts are set out briefly here for the Court's convenience.

Respondent and Petitioners are parties to agreements commonly denominated as gas lease-sales agreements ("GLAs") which were executed in the 1950s. Under these

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[1] Petitioners correctly state the parties to this proceeding with the exception that Respondent and Sun Exploration and Production Company ("Sun") have agreed to settle all matters at issue with regard to Sun's gas lease-sale agreement.

agreements, Respondent acquired gas leasehold rights for properties located in the San Juan Basin of New Mexico. In exchange for the leases, Respondent agreed to pay cash for the wells located on the properties and agreed to pay for the gas and liquefiable hydrocarbons on the basis of an overriding royalty that was subject to escalation over a specified period of time and thereafter subject to redetermination based on the fair market value of the gas. The parties agreed to arbitration in the event they were unable to agree as to future overriding royalties.[2]

As a result of rate filings made by Respondent with the Federal Energy Regulatory Commission ("FERC"), effective October 1, 1983, the GLA Properties became unprofitable to Respondent.[3] It, therefore, exercised its right, granted under certain of those agreements, to reassign "unprofitable wells" and "non-commercial acreage". It also sought a declaratory judgment in this case confirming those rights. The state district court ruled against Respondent. The Texas Court of Appeals reversed and rendered that portion of the judgment relating to those GLA agreements that had an unprofitably clause and an undeveloped acreage clause. The Texas Supreme Court refused to grant a discretionary writ of error

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[2] The amount of Petitioners' royalty bore no relation to and was not dependent upon the amount which Respondent recovered through sale of the gas.

[3] Respondent, as an interstate pipeline subject to the Natural Gas Act, 15 U.S.C. § 717-717u (1982), is required to file its rates with the FERC. It may make periodic adjustments to those rates based on changes in purchased gas costs at specified intervals. *See* 18 C.F.R. § 154.38(d)(4). El Paso's purchase gas adjustment ("PGA") filing effective October 1, 1983 which implemented NGPA pricing for its pipeline production was the result of a settlement of a rate case to which Petitioners were parties. *See El Paso Natural Gas Co.* 26 F.E.R.C. (CCH) ¶61,365 (1983). Under that settlement El Paso agreed to implement NGPA pricing in its first PGA filing after this Court's decision in *Public Service Comm'n of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983). No appeal was taken from that rate case by Petitioners.

to review that decision with the notation "no reversible error." Petitioners' application to stay the mandate of the Texas Court of Appeals pending certiorari was denied by the Court on December 14, 1987.

IV.
REASONS WHY THE PETITION SHOULD BE DENIED

1. The decision of the Texas Court of Appeals does not raise the Question Presented in the petition.

The sole Question Presented in the petition is:

> Whether an interstate natural gas pipeline company can utilize an incorrect application of federal law governing natural gas, and a misconstruction of this Court's interpretation of such federal law in *Public Service Comm'n of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983), to destroy Petitioners' property interests in natural gas producing properties operated by the pipeline, which interests were recognized and preserved by a final holding of the United States Court of Appeals for the Fifth Circuit.

The Texas Court of Appeals did not construe or rely on any federal statute and its judgment did not "destroy" Petitioners' interest in the properties in question. The court's judgment allows Respondent to reassign the properties to Petitioners, making them the outright owners of fully developed, producing gas wells rather than overriding royalty interest owners.

The judgment of the Texas Court of Appeals was based solely on state law. The sole issue before the court was whether Respondent was entitled, under the terms of the GLAs, to reconvey certain wells and acreage to Petitioners. The GLAs contained clauses that allowed Respondent the option to reconvey wells and drilling units to Petitioners in the event they became unprofitable and required Respondent to reassign undeveloped acreage in the event that it would not be productive of gas in commercial quantities.

App. at 8a.[4] The Texas Court of Appeals made it clear that the construction and application of these controversial clauses "substantially control this case." App. at 10a.[5] The court held that, in determining whether a well had become unprofitable, or whether acreage would be productive in commercial quantities, Respondent was entitled to deduct, as a cost of production, the overriding royalties it was obligated to pay Petitioners under the terms of the GLAs. App. at 10a-14a. Because the amount of royalties exceeded the price Respondent recovered for the gas produced, the wells and acreage had become unprofitable and could, therefore, be reassigned to Petitioners under the operative clauses in the GLAs. App. at 6a, 28a.

Petitioners' contention that the court misinterpreted this Court's opinion in *Public Service Comm'n of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) ("*Mid-Louisiana*"), disregards the fact that the interpretation of that decision was not a factor in the court's judgment. Had the court interpreted *Mid-Louisiana* in a wholly contrary manner, or simply omitted any reference to the case, the judgment would remain unaffected.

Contrary to Petitioner's claim, the Texas Court of Appeals did not hold that Respondent properly abandoned costs-of-service pricing and implemented producer parity pricing. The court merely reviewed the facts as presented and declared the rights of the parties under the contracts in question. The determinative fact, which was not disputed, was that Respondent had paid and was paying to Petitioners more in royalties than it collected for the gas produced. The court did not hold that the prices Respondent had charged for the gas were too high or too low, proper or improper. It

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[4] All citations are to Petitioners' Appendix.

[5] An additional clause, the "500 Mcf Clause," is not a part of Petitioners' application.

merely stated, as an undisputed fact, what prices Respondent had collected for the gas.[6]

Petitioners contended in the Texas Court of Appeals that Respondent had a duty, under Texas law, to sell the gas produced from the leases at a price sufficient to prevent the wells from becoming unprofitable. App. at 18a, 19a. That contention was squarely rejected. *Id.* The court agreed with Petitioners that Respondent could seek, and the FERC could authorize, a higher price than that fixed by the Natural Gas Policy Act. App. at 18a. Because Respondent had no duty to seek a higher price for the gas, the question of what price Respondent could have obtained was academic.

2. The Supreme Court does not have jurisdiction to review the decision of the Texas Court of Appeals.

As is readily apparent from the Texas Court of Appeals decision, the court's holding turned exclusively on a question of state law, namely, the duty owed by Respondent to market the gas produced in such a way as to keep the properties profitable. The court found, as a matter of state oil and gas law, that Respondent had no such duty since Petitioners' royalty income did not depend on the price at which the gas was sold.

This Court will not review a state court decision that was decided exclusively on state law grounds. 28 U.S.C. § 1257

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[6] Petitioner's assertions that El Paso is somehow precluded from repricing its pipeline production previously included in its rates on a cost-of-service basis are in error. El Paso was specifically granted such authority by the FERC for all periods after June 1, 1982. *See El Paso Natural Gas Co.*, 20 F.E.R.C. (CCH) ¶ 61,443 at p. 61,913 (1982). It deferred such repricing until after this Court's decision in *Mid-Louisiana* by agreement in settlement of its rate case in Docket RP 82-83. See note 3, *supra*. Further, Petitioners reference to *Kentucky-West Virginia Gas Co.* 21 F.E.R.C. (CCH) ¶ 61,257 (1982) is misplaced. In that case, relying on its previous decision in *El Paso Natural Gas Co., supra*, the FERC allowed *Kentucky-West Virginia Gas Co.* to reprice its pipeline production prospectively after the expiration of its rate case settlement agreements. 21 F.E.R.C. (CCH) at p. 61,555.

(1982); *Exxon Corp.* v. *Eagerton*, 462 U.S. 176 (1983). Nor will the Court review a state court judgement that rests on adequate and independent state grounds merely for the purpose of rendering an advisory opinion on a question of federal law. *Herb* v. *Pitcairn*, 324 U.S. 117, 125-126 (1945). Yet Petitioners ask this Court to review the judgment of the Texas court on an issue that it did not reach and which would not affect the Texas court's judgment.

The petition should be declined because this Court lacks jurisdiction to review the case under 28 U.S.C. § 1257 (1982).

3. The sole Question Presented in the petition is one of fact, which the Texas Court of Appeals found unnecessary to decide.

The essence of Petitioners' Question Presented is that the Texas court erred in finding that the maximum lawful price that Respondent could charge for the gas produced was based on producer-parity pricing. Petition at 10, 11. However, the Texas Court of Appeals found it unnecessary to decide this question since the court found, as a matter of law, that Respondent had no duty to market the gas at the highest lawful price. App. at 15a-19a. The factual question of whether Respondent might have been able to obtain a higher price for the gas from the FERC was, therefore, academic.[7] The question was, moreover, assumed in Petitioners' favor. App. at 15a.

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[7] Petitioners are in error when they state that Respondent's "NGPA rate on the GLA gas was its cost-of-service rate which included royalty payments to Petitioners." Petition at 10. Further, they misstate the recent holdings of the FERC in Order 391-B, "First Sales of Pipeline Production Under Section 2(21) of the Natural Gas Policy Act of 1978," 40 F.E.R.C. (CCH) ¶ 61,174 (1987), reh'g granted, 52 Fed. Reg. 37,928 (Oct. 13, 1987). In Order 391-B, the FERC held that a cost-of-service rate is *not* the appropriate rate under § 104 (b)(1) because ". . . the Commission never established a just and reasonable rate for pipeline produced old gas." *Id.* at 61,545. The Commission noted that in the rare instance where continuation of cost-of-service treatment

The Texas Court of Appeals found that, while Respondent could have sought and the FERC could have authorized a higher price, Respondent had no duty to seek such a price. App. at 15a. The question of Respondent's implied duty to Petitioners, or the lack of any such duty, is simply not a federal question. Any judgment this Court could render on any federal question related to this case would be an advisory opinion on a question that was conceded by the Texas court.

4. This Court will not review a state court judgment on an academic or episodic question of law.

The questions of law involved in this litigation are necessarily of limited public importance, arising from a highly unusual, if not unique, set of facts. Respondent has conveyed fully developed and producing gas wells worth millions of dollars to Petitioners, free of all costs of development and production, solely because the royalties Respondent must pay petitioners exceed the revenues produced by the wells. The sole question presented in the Texas court was whether Respondent had a right to do so under the terms of the GLAs and whether the exercise of this right violated any implied duty owed to Petitioners by Respondent under Texas law. Such a question had never before been litigated for the simple reason that gas lease operators infrequently find it necessary or desirable to engage in litigation in order to give away millions of dollars worth of property. The question is unlikely ever to arise again and is of significance only to the immediate parties. This Court will not review questions of importance only to the parties involved in the litigation. *Layne and Bowler Corp.* v. *Western Well Works,* 261 U.S. 387, 393 (1923); *Rice* v. *Sioux City Cemetery,* 349 U.S. 70, 79 (1955). For these reasons, the petition should be denied.

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would result in a higher rate than the otherwise applicable NGPA ceiling price it would undertake case-specific review for continued availability of cost-of-service pricing. *Id.* at 61,546 n.11.

V.
CONCLUSION

For all the reasons stated, and in particular because this Court lacks jurisdiction, the petition should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Robert J. King, a member of the Bar of this Court, hereby certify that on this 13th day of January, 1988, a copy of the Reply to Petition for a Writ of Certiorari in the above-entitled case was mailed, first class postage prepaid, to Charles M. Darling, IV, Steven R. Hunsicker, John P. Babb, Baker & Botts, 1701 Pennsylvania Avenue, N.W., Washington, D.C. 20006, counsel for Petitioners, Fina Oil and Chemical Company, *et. al.* I further certify that all parties required to be served, have been served.

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PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

INTRODUCTION

Respondent's Brief in Opposition sets forth two basic arguments for denial of the petition filed in this cause. First, Respondent argues that the judgment of the Texas Court of Appeals was based solely on state law and did not draw into question any federal statute. Second, Respondent argues that even if the judgment of the court below presents a federal question, the petition should be denied because the question of federal law is only of "academic" interest.

As shown below, Respondent's arguments cannot withstand analysis. The judgment of the Texas Court of

Appeals is predicated upon an interpretation and application of federal law, as Respondent itself argued below. Second, the state court's interpretation and application of federal law not only threatens to destroy Petitioners' property rights but also creates a fundamental conflict between federal and state authorities construing the federal statute at issue. Third, the state court's judgment refuses the appropriate preclusive effect to which a prior judgment of the United States Court of Appeals is entitled.

Granting Petitioners' writ is entirely appropriate under these circumstances.

ARGUMENT

1. The State Court's Decision Below Was Predicated On An Interpretation And Application Of Federal Law.

In its Brief in Opposition, Respondent mischaracterizes the case below as involving exclusively state contract law.[1] As the Texas court's opinion demonstrates, the holding of the state court was dependent upon the court's interpretation of the Natural Gas Policy Act of 1978 ("NGPA"),[2] and the state court's reading of *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) [hereinafter *"Mid-Louisiana"*]. *See El Paso Natural Gas Co. v. American Petrofina Co. of Texas*, 733 S.W.2d 541, 545-46 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e), App. 1a, 4a-6a.[3]

The state court's opinion further demonstrates that the federal issues were of primary importance. Prior to even reaching the contract issue—whether Respondent

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[1] Brief in Opposition at 2.

[2] 15 U.S.C. §§ 3301, *et seq.* (1982).

[3] Citations in this Reply Brief to the Appendix to the Petition for Certiorari are cited as "App." Citations to the Supplemental Appendix attached to this Reply Brief are cited as "Supp. App."

was entitled to terminate Petitioners' royalty interests in properties pursuant to a so-called "unprofitability" contract clause[4]—the court necessarily addressed Respondent's claim that the NGPA, as interpreted by this Court in *Mid-Louisiana*, required interstate pipelines to abandon cost-of-service pricing in favor of producer-parity pricing. The court was required to resolve this issue because Respondent claimed that this change in federal law had rendered the properties unprofitable and Petitioners' royalty interests therefore subject to termination under the agreements at issue.

In fact, Respondent represented before the state court that the interpretation and application of federal law was central to this controversy. In its brief to the Texas Court of Appeals, Respondent argued that "unprofitability occurred only because of the Natural Gas Policy Act of 1978 as definitively interpreted by the United States Supreme Court [in *Mid-Louisiana*] in 1983."[5] Respondent further represented to the court below that the controversy would not even exist but for the NGPA and *Mid-Louisiana*.[6]

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[4] Similar arguments were raised in connection with a "noncommercial acreage" clause. App. 6a.

[5] Reply Brief of Appellant El Paso Natural Gas Company at 2, Supp. App. SA-5.

[6] In its initial brief, Respondent made the following assertions:

> This declaratory action would not have been filed, nor would the present controversy among the parties exist, were it not for the occurrence of two events totally beyond the control of the parties.
>
> First, the Natural Gas Policy Act of 1978 (15 U.S.C. § 3301 *et seq.*) ("NGPA") was enacted by Congress and signed into law by the President. . . .
>
> Second, the United States Supreme Court held [in *Mid-Louisiana*] that the maximum lawful price provisions of the NGPA were applicable to natural gas produced by interstate and intrastate pipelines from their own wells, even though that

The judgment of the Texas Court of Appeals is based upon that court's acceptance of Respondent's own arguments as to the applicability of the NGPA as interpreted by *Mid-Louisiana*. *See* 733 S.W.2d at 545-46, App. 4a-6a. Respondent cannot now argue in good faith that the state court's judgment was not based upon a federal question.

2. The State Court's Interpretation And Application Of The Determinative Federal Issue Was Incorrect And Inconsistent With Federal Authority.

The foundation of the state court's holding below was that Respondent necessarily abandoned cost-of-service pricing and, as a result, the properties became unprofitable by operation of federal law.[7] Respondent's assertions to the contrary are unfounded.[8]

> gas moved into the pipeline without a traditional "sale" having occurred; thus, the intercompany transfer from a pipeline's production division to its transmission division [*e.g.* GLA production] was sufficient to render pipeline production subject to NGPA price ceilings . . . .

Brief of Appellant El Paso Natural Gas Company at 6, Supp. App. SA-2. (Footnotes omitted).

[7] *See* 733 S.W.2d at 545-46, App. 4a-6a.

[8] Again, Respondent's prior arguments before the state court reveal the transparency of its assertions before this Court:

> It must always be borne in mind that El Paso had no real alternative to invocation of those provisions of the GLAs which allow reassignment by El Paso in the event of unprofitability and noncommerciality. It is without dispute that unprofitability and noncommerciality do not stem from high drilling costs or high operating costs which El Paso might be able to control with careful management; rather, unprofitability and noncommerciality arise solely because of the contractual obligation to pay Appellees a fixed amount per unit of gas produced and sold even though *El Paso's income stream had been forced below the level of the payments by operation of federal law.*

Brief of Appellant El Paso Natural Gas Company at 8, Supp. App. SA-3. (Emphasis added).

Respondent argued, and the Texas Court of Appeals accepted, that the abandonment of cost-of-service pricing was mandated by the NGPA as interpreted by this Court in *Mid-Louisiana*. However, this determination is incorrect as a matter of federal law. In *Public Utilities Comm'n of California v. FERC*, 817 F.2d 858 (D.C. Cir. 1987), the court specifically held that *Mid-Louisiana* did *not* mandate abandonment of cost-of-service pricing. *See also Columbia Gas Development Corp. v. FERC*, 651 F.2d 1146, 1156-57 (5th Cir. 1981). These decisions demonstrate, contrary to the opinion of the state court below, that Congress intended the NGPA to continue cost-of-service pricing unless the gas qualifies for higher incentive rates established by other pricing categories in the NGPA.[9]

The Texas court's decision stands in direct contradiction to the holdings of the Fifth and D.C. Circuit Courts of Appeal on this substantial question of federal law. Certiorari is appropriate in these circumstances where a state court decision conflicts with the decisions of federal courts on the application of federal law.[10]

3. The Decision Of The State Court Would Destroy Petitioners' Property Rights, Which Were Previously Affirmed In Federal Court.

Respondent incorrectly asserts that Petitioners' property interests were not destroyed as a result of the Texas court's decision.[11] To the contrary, the state court's decision threatens to nullify the same royalty interests

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[9] Pipelines may qualify for higher than cost-of-service rates if the gas "falls within one of the special categories of gas whose production Congress saw a need to stimulate." *Mid-Louisiana*, 463 U.S. at 343.

[10] *See, e.g.*, Edward Katzinger Co. v. Chicago Metallic Mfg. Co., 329 U.S. 394 (1947); MacGregor v. Westinghouse Electric & Mfg. Co., 329 U.S. 402 (1947).

[11] Brief in Opposition at 4.

that were affirmed, after more than a decade of litigation, in *El Paso Natural Gas Co. v. Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983), *cert. denied*, 468 U.S. 1219 (1984) [hereinafter "*Sun Oil*"].

In *Sun Oil* the Fifth Circuit held that Petitioners were entitled to maintain their royalty interests. 708 F.2d at 1016. Under the Texas court's decision, the overriding royalty interests affirmed in *Sun Oil* would be terminated, as Respondent itself has acknowledged.[12] Petitioners respectfully submit that certiorari should be granted in order to protect their property interests and to preserve the holding in *Sun Oil*.

CONCLUSION

The state court's decision below is premised upon the court's interpretation and application of the NGPA, and the court's reading of this Court's landmark decision in *Mid-Louisiana*. By adopting Respondent's interpretation of the NGPA and *Mid-Louisiana*, the Texas Court of Appeals committed a fundamental error of federal law and created a direct conflict with substantial federal authority. Moreover, the state court's error improperly threatens the destruction of Petitioners' property rights. These rights were previously affirmed by the United States Court of Appeals for the Fifth Circuit in *Sun Oil* and should be protected under the doctrine of *res judicata*.

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[12] *Id.*

Certiorari should be granted to correct the error of federal law committed by the state court below and to preserve the integrity of the Fifth Circuit's prior judgment.

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

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SUPPLEMENTAL APPENDIX

No. 01-84-00350-CV

IN THE COURT OF APPEALS
FOR THE SUPREME JUDICIAL
DISTRICT OF TEXAS
AT HOUSTON

EL PASO NATURAL GAS COMPANY,
Appellant,

v.

TENNECO OIL COMPANY, *et al.*,
Appellees.

On Appeal from the 11th Judicial District Court
of Harris County, Texas

BRIEF OF APPELLANT EL PASO NATURAL GAS COMPANY

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FACT STATEMENT PERTINENT TO POINTS 1 THROUGH 37

This is a general fact statement pertinent to Points of Error 1 through 37 raised by Appellant El Paso, Plaintiff below. Other facts may be discussed in more detail under the points to which they are applicable.

A. Background of the Controversy

This declaratory judgment action would not have been filed, nor would the present controversy among the parties exist, were it not for the occurrence of two events totally beyond the control of the parties.

First, the "Natural Gas Policy Act of 1978" (15 U.S.C. § 3301 *et seq*) ("NGPA") was enacted by Congress and signed into law by the President. Under this far-reaching statute, it became both a civil and criminal violation of federal law to knowingly exceed the specifically listed maximum lawful prices prescribed in the NGPA, in a first sale of natural gas, whether the sale was made in interstate commerce or in intrastate commerce. 15 U.S.C. § 3414.

Second, the United States Supreme Court held that the maximum lawful price provisions of the NGPA were applicable to natural gas produced by interstate and intrastate pipelines from their own wells, even though that gas moved into the pipeline without a traditional "sale" having occurred; thus, the intra-company transfer from a pipeline's production division to its transmission division was sufficient to render pipeline production subject to NGPA price ceilings, and to make the producing pipeline subject to civil and criminal sanctions for a knowing violation of the statutory pricing structure.[3]

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[3] *Public Serv. Comm'n. of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 77 L.Ed.2d 668 (1983), *affirming Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d 530 (5th Cir. 1981) (*"Mid-La"*).

* * * *

It was El Paso's decision to exercise its rights of reassignment—of all existing wells under the "Unprofitability Clause" and of all undeveloped acreage under the "Undeveloped Acreage Clause"—that precipitated this declaratory judgment action (SF 11/30 at 58-61).

It must always be borne in mind that El Paso had no real alternative to invocation of those provisions of the GLAs which allow reassignment by El Paso in the event of unprofitability and noncommerciality. It is without dispute that unprofitability and noncommerciality do not stem from high drilling costs or high operating costs which El Paso might be able to control with careful management; rather, unprofitability and noncommerciality arise solely because of the contractual obligation to pay Appellees a fixed amount per unit of gas produced and sold even though El Paso's income stream had been forced below the level of the payments by operation of federal law (SF 11/30 at 29-30; 12/15 [p.m.] at 14-19).

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SA-4

No. 01-84-00350-CV

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FOR THE SUPREME JUDICIAL
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EL PASO NATURAL GAS COMPANY,
Appellant,

v.

TENNECO OIL COMPANY, *et al.*,
Appellees.

On Appeal from the Eleventh Judicial District Court
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REPLY BRIEF OF EL PASO NATURAL GAS COMPANY

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* * * *

In contrast to *Sun Oil*, El Paso seeks in this proceeding to obtain a declaration that, on August 1, 1983, El Paso validly exercised its option set forth in the GLAs to reassign unprofitable wells and non-commercial undeveloped acreage to Appellees, and that certain overriding royalty interests had converted to working interests. This Court will surely recognize that of paramount importance in evaluating this claim is the simple fact that unprofitability did not exist until long after the Midland District Court trial had ended, and long after the FPC proceedings had been concluded. Factually, unprofitability occurred only because of the Natural Gas Policy Act of 1978 as definitively interpreted by the United States Supreme Court in *Mid-La*[6] in 1983. If unprofitability did not exist until 1983, it could not have been litigated in the 1973-1975 prior litigation between these parties.

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[6] *Public Service Commission of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 72 L.Ed. 2d 668 (1983).